Jurisdictional Statement

81-2080

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No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

RUSSELL STOVER CANDIES, INC.
a Missouri corporation,

Appellant,

— v —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,

Appellee.

On Appeal from the Supreme Court of Montana

JURISDICTIONAL STATEMENT

WARD A. SHANAHAN
301 First National Bank Building
P.O. Box 1715
Helena, MT 59624-1715
(406) 442-8560

Counsel for Appellant

QUESTIONS PRESENTED

1. Whether a State, without violation of the Due Process Clause of the Fourteenth Amendment to the Constitution, may apply a unitary business formula to a corporation and thereafter tax, as the corporation's income from its business activities conducted within the taxing State, income derived from other operations of the corporation where:

(a) The business activities of the corporation outside the taxing State are involved in the maufacture, sale and distribution of paper boxes and related products, none of which occur in the taxing State, and the business activities of the corporation in the taxing State are limited to the operation of two cattle ranches which do not functionally contribute to or functionally assist the other activities of the corporation; and

(b) The sole connection between the business activities of the corporation in and out of the taxing State consist of the provision of some central management services to the cattle ranches by the home office of the corporation, located outside the taxing State, and the transfer of funds between the operations of the corporation in the taxing State and the general account of the corporation; and

2. Whether a State, without violation of the Due Process Clause of the Fourteenth Amendment to the constitution, may apply a unitary business formula to a corporation conducting business both within and outside the taxing State, where use of the formula results in the apportionment to the taxing State of 19% to 30% of the corporation's total net income, when

(a) The business operations of the corporation within the taxing State sustained losses in all the years involved; and

(b) The percentage of net income apportioned to the taxing State is four to five times the percentage of gross sales derived from the corporation's operations within the taxing State.[1]

[1] The Appellant has no parent companies, subsidiaries or affiliates. The party in the lower courts, Ward Paper Box Company, has been merged into Russell Stover Candies, Inc., which is the surviving corporation.

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JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the Supreme Court of the State of Montana is reported as *Ward Paper Box Company v. Department of Revenue of the State of Montana*, 638 P.2d 1053 (Mont.1981). Included in the Appendix to the Jurisdictional Statement are copies of that opinion (App. A, pp. 1-9); the unreported Opinion and Order of the District Court of the First Judicial District of the State of Montana, in and for the County of Lewis and Clark (the "District Court") (App. A, pp. 12-19); the unreported Findings of Fact, Conclusions of Law and Order of the State Tax Appeal Board of the State of Montana (App. A pp. 20-30); and the unreported decision of the Hearing Officer of the Department of Revenue (App. A, pp. 31-38).

JURISDICTION

This proceeding involves the application of Montana's corporate license tax statutes. Appellant challenged the decision of the Department of Revenue of the State of Montana to apply a "unitary business formula" to the operations of Ward Paper Box Company located within and outside the State of Montana for the purposes of computing the income tax due to the State of Montana. Appellant challenged this action on both statutory and constitutional grounds.

Appellant's arguments were rejected by the State Tax Appeal Board of the State of Montana and Appellant filed a Petition for Judicial Review with the District Court. Appellant's statutory arguments were upheld by the District Court. In its December 1981 decision, the Montana Supreme Court reversed and held that the unitary formula was properly applied to the operation of Appellant for the taxable years 1971 through 1975. As a result, income from operations occurring completely outside of Montana was included within the net income of the corporation for the purposes of computing the corporate license tax imposed upon Ward Paper Box Company in tax years 1971 through 1975.

The Montana Supreme Court rendered its decision on December 21, 1981. Appellant filed a motion for rehearing which was denied by the Montana Supreme Court by Order dated January 14, 1982. Appellant filed its notices of appeal with the Montana Supreme Court and the District Court on March 19, 1982.

This appeal is taken pursuant to the provisions of 28 U.S.C. § 1257(2).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case involves the Due Process Clause of the Fourteenth Amendment to the Constitution:

> No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty or property without due process of law. . . .

Section 15-31-301, Montana Code Annotated (MCA), states:

> *Corporations subject to allocation and apportionment.* (1) Any corporation having income from business activity which is taxable both within and without this state shall allocate and apportion its net income as provided in this part.
>
> (2) A corporation engaged in a unitary business within and without Montana must apportion its business income as provided for under 15-31-305. A business is unitary when the operation of the business within the state is dependent upon or contributory to the operation of the business outside the state or if the units of the business within and without the state are closely allied and not capable of separate maintenance as independent businesses.
>
> (3) A corporation not engaged in a unitary business must allocate its business income by means of separate accounting methods, provided its books and records are so kept that the income and expenses attributable to business operations within the state can be properly segregated from total income and expense. If the corporation's books and records do not permit such proper segregation, its business income must be apportioned according to the provisions of 15-31-305.

STATEMENT OF THE CASE

Appellant, Russell Stover Candies, Inc., is the successor to all interests of Ward Paper Box Company, the taxpayer

in the proceedings below. Ward Paper Box Company, a Missouri corporation, was merged into Russell Stover Candies, Inc., a Missouri corporation, which is the surviving corporation, by documents filed December 21, 1981. By order of the District Court dated March 19, 1982, Russell Stover Candies, Inc. was substituted for Ward Paper Box Company in this action. (App. D, pp. 49-50.)

Ward Paper Box Company was, in tax years 1971 through 1975, engaged in the business of manufacturing, distributing and selling paper boxes and related products. It was a Missouri corporation qualified to do business in Montana. It maintained its principal place of business in Kansas City, Kansas. All of its common stock was owned by Mr. Louis Ward. (App. A, pp. 2, 13.)

During the years in question, the activities of Ward Paper Box Company consisted of seven divisions. The divisions located outside of Montana were involved in the manufacture, sale and distribution of paper boxes and paper box products in the states of Kansas, Missouri, Colorado, South Carolina and Virginia. The Montana divisions consisted of two cattle ranch divisions; one in Meagher County and one in Powell County, Montana. (App. A, pp. 2-3, 13-14.) The paper box divisions did not manufacture, distribute or sell paper boxes or paper box products in Montana or engage in agricultural or livestock activities in Montana. The ranch divisions operated solely in Montana. (App. A., p. 21.) The Montana State Tax Appeal Board recognized that the corporation was engaged in two business activities. (App. A, p. 27.)

At the Montana ranch divisions, the resident ranch manager made day-to-day managerial decisions. However, major decisions concerning the ranch divisions required the approval of Mr. Louis Ward or the President of the Company. The Kansas City home office of the corpor-

ation made major financial decisions for all divisions, prepared all federal and state reports, hired accountants to prepare tax returns, kept all books, prepared financial statements and balanced all checkbooks. There were no joint advertising programs, no common salesmen or common guarantees among the divisions. Personnel of the box divisions did not transfer to the ranch divisions. The divisions did not exchange equipment and did not purchase products jointly.

Each division, including the Montana divisions, had an expense bank account maintained in a bank in Kansas City. Any monies generated by the division were deposited in the division's expense account. If the division did not immediately need the funds, those funds would be transferred from the separate division expense account to a general account of Ward Paper Box Company. Such funds would thereafter be utilized when needed in any of the separate division operations. The President of Ward Paper Box Company would make the decision as to such transfers.

When either of the Montana ranch divisions did not generate enough income to meet expenses, additional funds would be transferred from the general account to the ranch divisions' expense accounts. Each ranch division maintained a payroll account in a Montana bank. Checks on those accounts could be written by the ranch manager, however, records were maintained in the Company's home office which also balanced the books and made deposits to the payroll account. (App. A, pp. 3-4, 14-15, 23-27.)

For the years 1971 through 1975, Ward Paper Box prepared and filed its Montana tax returns using a separate accounting method for the Montana ranch divisions. In each year, it paid the minimum corporation

license tax of $50.00. During those years, the operating costs and depreciation expenses of the Montana divisions exceeded the income generated by those divisions. During the same time period, Ward Paper Box filed tax returns under the unitary apportionment method in the other states in which it operated. The Montana ranch divisions were included as a part of its total unitary business in those returns. (App. A, pp. 2-3, 26.)

Appellee, Department of Revenue, determined that the Montana activities of Ward Paper Box Company were part of a unitary business. Thereafter the Department applied a unitary business formula in which the total income of the corporation, including the income generated from other divisions, was apportioned to Montana by use of a three-factor formula involving property, payroll and sales of the Montana operations in relation to the total property, payroll and sales of the corporation. The result was divided by three and yielded a percentage which as applied to total net income of the corporation to determine the income apportioned to the State of Montana.

The following table shows the computation made by the Appellee for the tax years involved:

	1975	1974	1973	1972	1971
SALES FACTOR					
From Sch 8 & 9					
Montana	$ 667,267	$ 673,011	$ 547,902	$ 110,732	$ 356,581
Total	9,045,536	10,055,532	8,408,684	9,753,830	7,222,509
Percent	7.3768%	6.6929%	6.5159%	1.1353%	4.9371%
PAYROLL FACTOR					
From Sch 6 & 7					
Montana	$ 295,737	$ 252,170	$ 229,777	$ 108,446	$ 62,843
Total	1,899,768	2,143,877	2,015,888	1,821,589	1,920,762
Percent	15.5670%	11.7623%	11.3983%	5.0534%	3.2718%

	1975	1974	1973	1972	1971
PROPERTY FACTOR From Sch 3-5					
Montana	$11,874,356	$11,189,290	$10,565,751	$ 7,214,208	$3,874,730
Total	17,417,592	16,615,058	14,970,861	11,190,376	7,649,961
Percent	68.1745%	67.3443%	70.5754%	64.4680%	50.6503%
Total Factors	91.1183%	85.7995%	88.4896%	71.5567%	58.8592%
(div.3) Aver.	30.3728%	28.5998%	29.496%	23.8522%	19.6197%
Total Net Income	2,186,167	1,843,150	1,567,917	1,847,209	1,970,447
Income Allocated to Montana	664,000	527,137	426,481	440,600	386,596

Ward Paper Box challenged the application of the unitary business formula on both statutory and constitutional grounds. The State Tax Appeal Board of the State of Montana rejected both these challenges (App. A, pp. 27-30). As indicated above, the District Court upheld Appellant's statutory argument (App. A, pp. 12-19) and the Montana Supreme Court reversed, rejecting Appellant's statutory and constitutional arguments (App. A, pp. 1-9).

The questions sought to be reviewed were raised in the District Court in Appellant's Petition for Judicial Review of the decision of the State Tax Appeal Board of the State of Montana. That Petition was filed on October 29, 1979. The questions were extensively briefed by the parties in the District Court. The District Court held that the activities of Ward Paper Box Company within the State of Montana were not part of a unitary business. The District Court based its decision on statutory grounds and did not specifically address the constitutional questions. The Montana Supreme Court, in reversing the District Court, held that the Montana divisions of Ward Paper Box Company

were a part of a unitary business and rejected the constitutional arguments of Appellant.

The questions sought to be reviewed herein were raised in the Supreme Court of the State of Montana in the brief of the Appellant and extensively briefed by the parties. They were raised again in the Appellant's Motion for Rehearing.

REASONS FOR NOTING JURISDICTION

This case involves substantial federal questions. The decision of the Montana Supreme Court represents an extension of the unitary business principle not previously sanctioned by this Court. Further, the Montana Supreme Court's decision has the effect of eliminating the requirement of a rational relationship between the income attributed to the taxing State and the intrastate values of the enterprise once a unitary business formula is found applicable.

There are two significant federal questions involved here. The first is whether a State may constitutionally apply a unitary formula to a corporation whose operations within the taxing State form distinct business enterprises which are functionally separate and apart from the operations of the corporation outside the taxing State. Here, the sole connections between the corporation's Montana-based operations and its other operations are unity of ownership, the provision of some management services and the transfer of funds. The decision of the Montana Supreme Court, given the facts of this case, represents an extension of the unitary business principle never before sanctioned by this Court. This initial question presents the Court with an opportunity to delimit the application of the unitary business principle.

The second question is whether a State may constitutionally apply a unitary business formula which appor-

tions to the taxing State and subjects to taxation 19% to 30% of the net income of the corporation, derived from all of its operations, when the business operations of the corporation within the taxing State produced only 1% to 7% of the Company's gross sales for the tax years in question, when the business operations within the taxing state sustained losses in all the years involved and produced no net income, and when the percentage of net income apportioned to the taxing State is four to five times the percentage of sales derived from the corporation's operations in the taxing State.

1. *Constitutionality of the application of the unitary business principal to a corporation whose operations within the taxing State are discrete business enterprises functionally separate from the corporation's out-of-state operations.*

Montana seeks, contrary to the Due Process Clause, to tax Appellant's extra-territorial net income by purporting to measure, by apportionment, the income attributable to Appellant's ranching activities within Montana. However, the activities conducted by the corporation outside of the state of Montana are functionally distinct and apart from the operations of the corporation within Montana. The unitary business principle was applied to the Appellant solely on the grounds that the corporation's Montana-based operations and its business enterprises located outside of Montana were all owned by Ward Paper Box Company, the capital stock of which was entirely owned by one individual. In addition, the corporation's home office provided some management and administrative services to the Montana-based operations, and funds were transferred between Appellant and its Montana-based operations. These facts do not present the connection required to constitutionally permit Montana to treat Appellant's

Montana-based operations and its out-of-state business enterprises as a unitary business.

Apportionment in the field of state income taxation is based upon the unitary business principle. That principle requires the Appellant to show, in order to establish that its income from operations outside the state of Montana is not subject to an apportioned tax in Montana, that the income was earned in the course of activities unrelated to its activities in that state. *Mobil Oil Corporation v. Commissioner of Taxes*, 445 U.S. 425, 439 (1980). Appellant has demonstrated that its business of manufacturing, distributing and selling paper boxes and related products outside the state of Montana is distinct, in any business or economic sense, from its ranching activities in Montana. The Appellant's ranching activities in Montana are a discrete business enterprise. Appellant's paper box business activities outside the state of Montana do not have the requisite nexus with the Montana activities of the corporation, and, therefore, the income from those operations cannot constitutionally be subjected to an apportioned tax in Montana. Where, as here, the business activities of the corporation outside the taxing State have no functional connection with the activities of the corporation within the taxing State, due process considerations preclude apportionability because there is no underlying unitary business. *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. at 442; *Exxon Corporation v. Wisconsin Department of Revenue*, 447 U.S. 207, 223-24 (1980).

The unitary business principal is sanctioned for use when the profits of the corporation are largely earned by a series of transactions beginning with manufacture in one state and ending with sale in other states. The formula is meant to assist legislatures and taxing agencies, faced with the impossibility of allocating specifically the profits

earned by the processes conducted within a state's borders, with a method by which to reach profits earned within the state. *Underwood Typewriter Company v. Chamberlain*, 254 U.S. 113, 120-21 (1920). In this case, Montana was not faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders. Appellant, in each of the tax years involved, filed reports using a separate accounting method for its Montana operations. Appellant was able to determine its gross receipts from its Montana ranch operations and to compute the expenses incurred by those operations. The expenses of the Montana operations included a flat $60 per month charge payable to the home office of the corporation for provision of some administrative services. Montana, nonetheless, decided to apply the unitary business principal to Appellant's operations. That decision was upheld by the decision of the Montana Supreme Court.

The operations of the Appellant in Montana do not show that Montana was dealing with a corporation functioning through a series of transactions beginning with manufacture in one state and ending with sale in other states. Instead, the Appellant's Montana ranch operations were functionally distinct and apart from its paper box manufacturing, sales and distribution activities outside the state of Montana. Montana was not here privileged to look beyond its borders to the other property of the corporation in order to ascertain the true value of things within the corporation because the property of the corporation within the state of Montana was not part of an organic system of wide extent. *Wallace v. Hines*, 253 U.S. 66, 70 (1920); *Bass, Ratcliff, & Gretton v. State Tax Commission*, 266 U.S. 271, 282 (1924).

"One must look principally to the underlying activity . . . to determine the propriety of apportionability." *Mobil Oil Corporation v. Commissioner of Taxes*, 445 U.S. at 440. See also *Exxon Corporation v. Wisconsin Department of Revenue*, 447 U.S. at 223-24. The Appellant has maintained that, in view of the distinct business activities of its Montana operations in relation to its out-of-state enterprises, its Montana operations cannot be deemed a part of a unitary business. The decision of the Montana Supreme Court looks past underlying business activities and determines that the Montana operations are a part of a unitary business based upon the fact that there was unity of ownership, that the corporation's home office provided some management and administrative services to the Montana operations in return for payment of $60.00 per month by the Montana ranch divisions, that the expense accounts of the Montana divisions were maintained in Kansas City banks, and that funds were transferred between the corporation and the Montana divisions. These factors are all unrelated to the underlying business activities of the Montana operations.

The relative unimportance of these factors to the concept of "unity" was discussed in an article by Keesling and Warren. This article was cited favorably by this Court in *Mobil Oil Corporation v. Commissioner of Taxes*, 445 U.S. at 439. In the article, we find the following:

> It may be well that in many instances the central performance of certain functions on behalf of a number of commonly owned series of business activities, which from an operational standpoint, are separate businesses, may result in savings substantially similar to those just discussed. Before, however, it is concluded that the different groups of activities should be considered as constituting one business, it should clearly appear that the savings and advantages are substantial in relation to the income involved.

> *Central accounting, for instance, may result in some savings, but in most instances the amount is trifling in comparison to the income of the various series of business activities for which the accounting is performed. Alone considered, it is too weak a connecting link to bind into one business, what should be separate businesses. Similar observations may be made with respect to other centrally performed functions such as management, handling of insurance, advertising, and the purchase of supplies and equipment.*

Keesling and Warren, "The Unitary Concept in the Allocation of Income," 12 Hastings L.J. 42, 52 (1960) (emphasis supplied).

Indeed, all of the factors relied on by the Montana Supreme Court are the consequence of unity of ownership. Any owner, in the proper management of his assets, makes decisions as to the use of those assets, maintains accounts relating to their value, provides funds to maintain those assets, and applies the profits generated thereby as he deems necessary. The Montana statute, as construed and applied by the Montana Court, permits the application of the unitary business formula simply on the basis that an owner has exercised these incidents of ownership. The decision of the Montana Supreme Court is based solely on the exercise of the incidents of ownership and has no relation at all to the underlying business activities of the Montana operations or the other operations of the Appellant.

As this Court has noted, the form of business organization may have nothing to do with the underlying unity or diversity of business enterprises. *Mobil Oil Corporation v. Commissioner of Taxes*, 445 U.S. at 440. Here the form of business organization is a single corporation exercising its rights of ownership with relation to its Montana operations. That exercise of ownership rights has no relation to the question of whether the Montana operations form a

part of a unitary business. Where, as here, the Montana operations do not form a part of a functionally integrated enterprise and are, in fact, discrete business enterprises having no functional connection with the out-of-state operations of the Appellant, the unitary business principle cannot be applied and the income from the out-of-state operations of the taxpayer cannot be apportioned to Montana without violation of the Due Process Clause of the Fourteenth Amendment. The construction of Montana's statute by its Supreme Court and its application to the taxpayer present a clear violation of the Due Process Clause and present this Court with an important opportunity to define the limits of the unitary business principle.

2. *Constitutionality of State taxation of a corporation's net income, derived from operations both within and outside the taxing State, where the corporation's operations within taxing State had no net income, and the net income apportioned to the taxing State is 19% to 30% of the total net income of the corporation.*

For a state to tax income generated outside its borders in interstate commerce, due process requires that there be a minimal connection between interstate activities and the taxing state, and a rational relationship between the income attributed to the state and the interstate values of the enterprise. *Mobil Oil Corporation v. Commissioner of Taxes*, 445 U.S. at 436-37; *Moorman Manufacturing Company v. Bair*, 437 U.S. 267, 272-73 (1978). Here, the application of the three-factor formula to the operations of appellant both within and outside the state of Montana has produced an apportionment which is "out of all appropriate proportion to the business transacted by Appellant" in Montana. *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135 (1931).

In *Hans Rees' Sons*, this Court struck down, as arbitrary and unreasonable, a North Carolina tax which apportioned 80 percent of Appellant's income to North Carolina despite the fact the evidence tended to show that between 17% and 21% of Appellant's income had its source in that state. Such an allocation bore no reasonable relationship or appropriate porportion to the business transacted by Appellant in the taxing state.

This Court, in *Norfolk and Western Railroad Company v. Missouri State Tax Commission*, 390 U.S. 317 (1978), found that Missouri exceeded its constitutional authority when its mileage formula resulted in allocation of 8.28 percent of the railroad's total rolling stock to Missouri when an actual count showed that the rolling stock usually employed in the state comprised approximately 2.71 percent of the total fleet.

Butler Brothers v. McColgan, 315 U.S. 501 (1942), approved a formula which attributed a portion of the company's total profits to California. There, the Company, a unitary business selling dry goods and general merchandise in interstate commerce, operated a wholesale distributing house in San Francisco which maintained a stock of goods, served a separate territory, maintained its own sales force and handled its own sales and collection arrangements. In the tax year in question, the application of a three-factor formula resulted in an allocation of 8.14 percent of the corporation's net income to California. In the same year, the corporation had over 5.2 million dollars in sales from the San Francisco distributing house, which represented 7.85 percent of the company's total sales.

Here, the ranch divisions' expenses and deductions exceeded gross income in each of the years in question and there was no net income attributable to those divisions.

The sales of the ranch divisions constituted between 1% and 7% of the corporation's total sales. In spite of these facts, Montana applied a unitary business formula which allocated to Montana 19% and 30% of the corporation's net income. Indeed, in 1972, Montana sales represented 1.1 percent of total sales. Yet Montana allocated 23.8 percent of the corporation's net income to the Montana operations. The disapportionate nature of this allocation is far greater than those presented in *Hans Rees' Sons* and *Norfolk and Western*. The allocations determined by the Montana Department of revenue do not remotely approach the allocation approved in *Butler Brothers*.

There is no rational relationship between the income attributed to Montana and the intrastate values of the Montana activities. The Montana Supreme Court in its decision based its finding of a rational relationship upon its earlier finding that the Appellant's Montana operations were part of a unitary business.

> The "rational relationship" requirement is met in this case also. Ward was operated as a unitary business and as discussed earlier its operation in Montana was both dependent upon and contributory to its operation outside the state. Therefore, the portion of Ward's total income attributed to Montana under Montana's three-factor apportionment formula is rationally related to the intrastate value of the corporation. (App. A, p. 8.)

That Court's reasoning, if left intact, virtually eliminates the requirement of a "rational relationship." Once a business is found to be unitary, any portion of net income attributed to the taxing State is rationally related to the intrastate values. This circuitous reasoning should be corrected. It isn't "reasonable." It is fallacious and cannot be allowed to stand as authority to lawfully exercise taxing jurisdiction.

The most noteworthy difference between the facts in our present case and those presented in the controlling decisions, *Hans Rees' Sons*, *Norfolk and Western* and *Butler Brothers*, is that here the corporation has no interstate transactions involving the movement of goods manufactured in one state for sale in another, or the continuity of a transportation system for interstate commerce between parts of the same company. Therefore, the application of the formula not only "distorts" the income attributable to the State of Montana, it operates to include income which is produced by a discrete business operating wholly beyond the borders of the State. No corporate organization or accounting system conceals these facts. They are apparent, and the formula was applied in spite of them. Thus, the application of the formula results in the allocation to Montana of between 19% and 30% of the net income of the corporation, derived from all of its operations, to Montana. This allocation is made despite the fact that the Montana operations of the corporation sustained losses in each of the years at issue here. In each of these years involved, the allocation to Montana of between 19% and 30% of the total net income of the corporation are four to five times greater than the Montana sales percentage of the total sales of the corporation. This clearly results in taxation of extraterritorial values.

The functional value of the Montana operations, in terms of producing income taxable under the corporation license tax, can only result from the sales made by the Montana operations. In each of the years involved, the gross sales of the Montana operations ranged between 1.1% and 7.3% of the total sales of the corporation. However, the total amount of net income allocated to Montana ranged from 19.6% to 30.3% of the corporation's total net income. This "distortion" is obviously caused by the "property factor" in the formula, and in

effect, converts the tax from an income to a property tax. If the nature of the tax under consideration has meaning, and we think it must, it is more than evident that extraterritorial values are being taxed when the percentage of income allocated to Montana exceeds by four to five times the percentage of income-producing sales made by the Montana operations.

In *Fargo v. Hart*, 193 U.S. 490, 499-500 (1904), Justice Holmes warned:

> It is obvious, however, that this notion of organic unity may be made a means of unlawfully taxing the privilege, or property outside the state, under the name of enhanced value or good will, if it is not closely confined to its true meaning.

While states cannot be held, by use of their apportionment formulas, to obtain exact measures of intrastate values, when the taxpayer's evidence is that the formula yields "a grossly distorted result in its particular case, the State is obliged to counter that evidence or to make accommodations necessary to assure that its taxing power is confined to its constitutional limits." *Norfolk and Western Railroad Company v. Missouri State Tax Commission*, 390 U.S. at 329.

The Appellant here maintains that this case presents clear and cogent evidence that extraterritorial values are being taxed as a result of the apportionment formula applied by the State of Montana to the operations of Appellant. As such, this case presents the Court with an opportunity to give definition to the requirement of a rational relationship between the income attributed to the state and the intrastate values of the enterprise. This substantial federal question requires plenary consideration by this Court for its resolution.

CONCLUSION

Appellant respectfully submits that the questions presented involve substantial federal issues and warrant plenary consideration by this Court following the submission of briefs and oral argument. Accordingly, probable jurisdiction should be noted.

Respectfully submitted.

Ward A. Shanahan
301 First National Bank Building
P.O. Box 1715
Helena, MT 59624-1715

Counsel for Appellant

May, 1980

Supplemental Appellant's Brief

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Appeal from the Supreme Court of the State of Montana

SUPPLEMENTAL BRIEF

Terry B. Cosgrove
4th Floor, Montana Club Bldg.
P.O. Box 1144
Helena, Montana 59624
(406) 442-7450

Michael J. Rieley
Montana Department of Revenue
Mitchell Building
Helena, Montana 59620

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U.S. SUPREME COURT RULES

Rule 16(6) 1

No. 81-2080

In the Supreme Court

of the United States

OCTOBER TERM, 1981

RUSSELL STOVER CANDIES, INC., a Missouri corporation, *Appellant*,

vs.

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA, *Appellee*.

Appeal from the Supreme Court of the State of Montana

SUPPLEMENTAL BRIEF

INTRODUCTION

Pursuant to Rule 16(6) of the Rules of the Supreme Court, Appellee hereby submits its Supplemental Brief in support of its Motion to Dismiss Appeal on file herein. This Court on June 29, 1982 issued decisions in the cases of *ASARCO Incorporated v. Idaho State Tax Commission*, 50 U.S.L.W. 4962 (1982) and *F.W. Woolworth Company v. Taxation and Revenue Department of New Mexico*, 50 U.S.L.W. 4957 (1982). Appellee had finalized and submitted for printing, its Motion to Dismiss Appeal, which

was filed on July 6, 1982 and therefore Appellee was unable to discuss in its motion, these very recent decisions. This brief addresses the two recent decisions of this Court in the *ASARCO* and *Woolworth* cases since they bear directly on the issue of state taxation of multistate businesses which is at issue in this present appeal before this Court.

ARGUMENT

In both the *ASARCO* and *Woolworth* cases, this court reiterated that "the linchpin of apportionability for state income taxation of an interstate enterprise is the unitary business principle." *F.W. Woolworth* 50 U.S.L.W. 4957 at 4959. The action by the Montana Supreme Court in the present case is totally consistent with that finding.

In the *Woolworth* case, the State of New Mexico attempted to include as apportionable business income, dividends received by the corporation from certain foreign subsidiary corporations. In order for New Mexico to justify the inclusion of the dividend income from the foreign subsidiaries as part of the apportionable income, this court held Woolworth and its foreign subsidiaries had to be conducting a unitary business operation. As a result, unless the facts were such as to show that the operations of Woolworth with its foreign subsidiaries did in fact meet the unitary business test, the State of New Mexico could not constitutionally apportion any of the dividend income.

When looking at the activities of Woolworth and its foreign subsidiaries, this court stressed that it is not the potential authority a parent has to manage its subsidiaries as a portion of its unitary business. But instead it is the management the parent actually asserts which is determinative. *Woolworth* p. 4959.

Looking at the facts in the *Woolworth* case, this Court found that there was no integration between Woolworth

and its subsidiaries since the subsidiaries operated autonomously and independently. The subsidiaries had their own separate and complete accounting department and financial staff; Woolworth did not engage in centralized purchasing, manufacturing, or warehousing for the subsidiaries; Woolworth had no centralized personnel training for subsidiary personnel; and each subsidiary was responsible for obtaining its own financing from sources other than Woolworth, at 4559. This court went on to note that the subsidiaries, independent of Woolworth, developed their own sales programs, developed their own managerial staff, and instructed that staff in their own methods of operation. Each subsidiary autonomously determined its own policies respecting its primary activity, retailing. The subsidiaries were responsible themselves for determining the size and location of their stores, market conditions and the items to be sold. Woolworth did not review subsidiaries tax returns or consult with the subsidiaries on decisions affecting taxes. Woolworth had no policy requiring that managers of the subsidiaries and Woolworth would have periodic meetings. The most that can be said is that Woolworth had irregular and infrequent contact and then only for the occasional oversight.

Contrast the Woolworth facts to the situation of the Appellant in the present case. Initially, it must be noted that this is not as in *Woolworth*, a question of the amount of control exercised by a parent over subsidiary corporations which have their own boards of directors and officers. In the present case this is one company operating through divisions and it is then a question of the amount of control exercised by the home office over such divisions. The treatment of these divisions by Appellant is not in any way similar to the treatment by Woolworth of its subsidiary corporations. Here the Appellant not only had the potential to control the operations of all of its divisions, it did in

fact control them. All management decisions, except for questions concerning the day to day operations, were made at the home office. All funds generated from any division were comingled and utilized for whatever needs of the entire corporation. All necessary and essential corporate services, including such minor items as balancing of checkbooks, preparing all government forms to be filed with any state agency or office, preparation of all tax returns, as well as all accounting functions were performed at the home office. The ranch divisions never generated sufficient cash in any one year of the audit, to meet its necessary expenditures. Rather than borrow any funds independently, the home office utilized funds generated by the non-ranch divisions to meet the ranch cash needs.

This court in the *Woolworth* decision made note of the fact that Woolworth conducted no joint purchasing program, warehousing etc. for it and its other subsidiaries. It is true that in the present case there were no such purchasing, warehousing, or merchandising programs utilized for the box and ranch divisions. However, it is also true that there were no such programs in existence as between the box divisions themselves. The Appellant has admitted that its box divisions are unitary, yet those divisions have no centralized purchasing office, centralized training program, centralized transfer of personnel, or centralized guarantees. This case does not present the situation of a corporation dealing in one fashion with certain divisions and in a wholly different manner with the Montana divisions. What is present is a taxpayer exercising strong centralized management, providing centralized services, providing needed capital requirements, operating in more than one product line as a unitary business.

The Appellant has consistently argued that Montana is attempting by use of formularly apportion and the unitary

business principle, to penalize the Appellant for exercising the necessary incidents of ownership. The F.W. Woolworth Company was able to exercise ownership and still not conduct a unitary business. However, the activities of the Appellant go far beyond merely exercising certain incidents of ownership. The Appellant, as contrasted to Woolworth, controls all but routine decisions, supplies all centralized services, and supplies all needed capital.

Also decided by this Court was *ASARCO Incorporated v. Idaho State Tax Commission*, 50 U.S.L.W. 4962. In that decision this Court found that the dividend income the State of Idaho was attempting to apportion was generated from corporations which were not conducting a unitary business operation with ASARCO. A nondomiciliary state will not be able to apportion or tax dividends "where the business activities of the dividend payor have nothing to do with the activities of the recipient in the taxing state." *ASARCO* at 4967. It must also be noted that ASARCO was not arguing that the dividend paying corporations were in fact conducting a unitary business, but argued instead that the dividend income met the definition of business income as contained in the Idaho statute.

The *ASARCO* decision in no way contravenes the decision of the Montana Supreme Court in the present case. The action of the Montana Supreme Court was founded on the unitary business principle, namely, that the divisions located in Montana were operating as a portion of a unitary business operating both within and without Montana. In order for Appellant's income to be apportionable in Montana, the Montana Supreme Court held that it must be generated as a portion of the unitary business operation.

> Ward was operated as a unitary business and as discussed earlier its operation in Montana was both dependent upon and contributory to its operation outside the state. There-

> fore, the portion of Ward's total income attributed to Montana under Montana's three-factor apportionment formula is rationally related to the intrastate value of the corporation.

App. Jur. St. p. 8.

CONCLUSION

The present case involves one corporation operating through seven divisions, with the out of state activities actually controlling the local activities to the extent that they constituted a unitary business operation.

It is respectfully submitted that the Appellant has failed to raise any substantial federal questions and that the most recent decisions of this court require dismissal of the appeal.

Respectfully submitted.

Terry B. Cosgrove
Special Assistant Attorney General
P.O. Box 1144
Helena, Montana 59624

Michael J. Rieley
Special Assistant Attorney General
Mitchell Building
Helena, Montana 59620

Appendix

81-2080

No. _____

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ALEXANDER L. STEVAS,
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

RUSSELL STOVER CANDIES, INC.
a Missouri corporation,

Appellant,

— v —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,

Appellee.

On Appeal from the Supreme Court of Montana

APPENDIX TO JURISDICTIONAL STATEMENT

WARD A. SHANAHAN
Counsel for Appellant
301 First National Bank Building
P.O. Box 1715
Helena, MT 59624-1715

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APPENDIX A

No. 80-375

IN THE SUPREME COURT OF THE
STATE OF MONTANA

1981

WARD PAPER BOX COMPANY, A Missouri corp.,
Respondent and Appellant,

— vs —

DEPARTMENT OF REVENUE OF THE STATE
OF MONTANA,
Appellant and Respondent

Appeal from:

District Court of the First Judicial District,
In and for the County of Lewis & Clark, The
Honorable Peter Meloy, Judge presiding.

Counsel of Record

For Appellant:
Terry B. Cosgrove, Helena, Montana
(Special Asst. Atty. General), Argued

For Respondent:

Ward A. Shanahan; argued, Helena, Montana
Gough, Shanahan, Johnson & Waterman, Helena,
Montana

Submitted: September 21, 1981
Decided: December 21, 1981

Filed: December 21, 1981

Thomas J. Kearney, *Clerk*

Mr. Chief Justice Frank I. Haswell delivered the Opinion of the Court.

This is an appeal by the Department of Revenue (DOR) from a judgment of the District Court of Lewis and Clark County vacating an assessment of additional corporation license taxes against the Ward Paper Box Company (Ward) for the years 1971 through 1975. We reverse.

Ward filed Montana corporation license tax returns for the years in question based on the segregated income from its Montana operations alone. DOR audited Ward's records, determined that Ward was a unitary business not entitled to separate accounting of its Montana operations and income, and assessed additional corporation license taxes against Ward by use of a three factor formula which apportioned to Montana a part of Ward's total income.

Ward protested this assessment to the State Tax Appeal Board (STAB). STAB affirmed the assessment by DOR. Ward filed a petition for review in the District Court of Lewis and Clark County. On August 4, 1980, the District Court reversed the STAB decision. DOR now appeals from the judgment of the District Court.

Ward is a Missouri corporation qualified and doing business in Montana, maintaining its principal place of business in Kansas City, Kansas. All of its common stock is owned by Mr. Louis Ward. Ward's activities consist of seven divisions; the divisions located outside of Montana are involved in manufacture, sale and distribution of paper boxes and paper box products in the states of Kansas, Missouri, Colorado, South Carolina and Virginia. The Montana divisions consist of two cattle ranches, one in Meagher County and one in Powell County.

For the years 1971 through 1975, Ward used the separate accounting method for filing its Montana tax

returns and in each year paid the minimum corporation license tax of $50. During those years the operating costs and depreciation expenses of the Montana divisions exceeded the income earned by those divisions.

During the same time period, Ward filed tax returns under the unitary apportionment method in the other states in which it was operating and the Montana ranch divisions were included as part of its total unitary business. In those states the losses sustained by the ranch divisions were used to offset income earned by the paper box divisions.

The facts regarding Ward's operations during the years in question are for the most part uncontested. The home office in Kansas City provided administrative services for all divisions of Ward's operation which included preparing federal and state reports, hiring the accountants to prepare tax returns, keeping the books, preparing financial statements and balancing check books. Each of the divisions was charged an arbitrary figure of $60 per month for the home office services. This figure was not based on the amount of time actually spent on each division by the home office personnel.

Ward's divisions did not exchange equipment or personnel and did not purchase products jointly. There was no joint advertising program among the various divisions and no common salesmen.

There were two accounts maintained for each division, an expense bank account and a payroll account.

Each division's expense bank account was maintained in a bank in Kansas City. Any monies generated by a division were deposited in that division's separate expense account. If the division did not immediatley need the funds, they would be transferred from the separate division ex-

pense account into a general account and would be utilized wherever needed by any of the separate divisions. The president of the company would make the decision as to the transfer. Excess funds would be invested, if not needed by any of the divisions. A portion of the short-term investment income was attributable to funds generated in Montana, yet the portion attributable to funds earned in Montana could not be specifically identified or segregated.

If either of the Montana ranch divisions did not generate enough income to meet expenses, additional funds would be transferred from Ward's general account to the ranch division's expense bank account.

The payroll account for each ranch division was maintained in a Montana bank and checks could be written on the account by the ranch manager. However the home office personnel maintained the records, balanced the books, and made the deposits.

There was some central management of the corporation. From the evidence presented at the hearing, STAB found that the home office made all of the decisions regarding the financial affairs of the corporation and that major decisions regarding the ranches, such as the purchase of equipment and the buying and selling of cattle, required the approval of the chairman of the board or the president of the corporation.

Based on its findings regarding Ward's operation, STAB held that Ward was a unitary business and that the DOR had properly assessed the additional taxes against Ward. The District Court reversed the STAB decision, and DOR appeals.

Two issues are raised on appeal:

1. Whether the Montana ranch divisions were part of Ward's unitary business requiring Ward to apportion its

total income for Montana corporation and license tax purposes.

2. Whether the proper standard of review was used by the District Court in reviewing the STAB decision.

In order to resolve the first issue we must look at the pertinent statutory language in effect for the years 1971 through 1975, the years for which Ward was assessed additional corporation license taxes.

In 1971 and 1972 section 84-1503, R.C.M.1947, provided in pertinent part:

> "If the income of any corporation from sources within the state cannot be properly segragated from income without the state, then, in that event, the amount of the net income returned shall be that proportion of the taxpayer's total net income which the taxpayer's gross business done in the state of Montana bears to the total gross business of the taxpayer, and apportionment shall be made under the rules and regulations prescribed by the state board of equalization, giving consideration to sales, property and payroll and such other factors as may be deemed applicable. . ."

A 1973 amendment of this section substituted the words "department of revenue" for "board of equalization."

The section was amended again in 1974 and as amended stated in part:

> "A corporation engaged in a unitary business within and without Montana must apportion its business income. . . A business is unitary when the operation of the business within the state is dependent upon or contributory to the operation of the business outside the state or if the units of the business within and without the state are closely allied and not capable of separate maintenance as independent business[es]."

This same rule was found in the administrative regulations prior to the 1974 amendment of section 84-1503. The regulations which contained this rule were effective for tax years beginning on or after January 1, 1967.

In Mont. Dept. of Rev. v. Am. Smelting & Refining (1977), 173 Mont. 316, 567 P.2d 901 (hereinafter cited as ASARCO), this Court held that the purpose of the 1974 amendment was to clarify the statute; we stated that the unamended version of the statute was not in conflict with the regulations in effect prior to the 1974 amendment and we upheld the administrative regulations. Therefore, the rule quoted above applied during the entire period in dispute, first as an administrative regulation and then as a statute in which that regulation was codified.

If Ward was a unitary business, it was required to apportion its business income for the purpose of the Montana corporation license tax. If the business was unitary, the income from sources within Montana could not be "properly segregated" from income without the state.

Segregating the income by source does not necessarily "properly segregate" the Montana income from the out-of-state income thereby making the use of the separate accounting method proper, any statement in *ASARCO*, supra, that might be interpreted to the contrary notwithstanding.

The United States Supreme Court has declared that a state is not precluded from taxing a corporation under the apportionment method even if the source of income may be ascertained by separate geographical accounting as long as the intra-state and extra-state activities are part of a single unitary business. Mobil Oil Corp. v. Com'r of Taxes of Vermont (1980), 445 U.S. 425, 100 S.Ct. 1223, 63 L.Ed.2d 510.

If the operation of Ward's business within Montana was dependent upon or contributory to its operation outside the state or if the Montana ranch divisions and the out-of-state paper box divisions were closely allied and not capable of separate maintenance as independent businesses, then the Montana ranch divisions were part of a "unitary business."

We find from the facts of this case that Ward's operation within Montana was dependent upon and contributing to its operation outside Montana. The Montana divisions were dependent upon the out-of-state operation for central services which included the preparation of federal and state reports, the hiring of accountants to prepare tax returns, the preparation of financial statements, the keeping of records, and the balancing of check books; for financing when funds in the ranch divisions' expense bank account were insufficient to meet the divisions' expenses; and for major management decisions which included the purchase of equipment and the buying and selling of cattle.

Ward's operation within Montana also contributed to its operation and net income outside the state. The Montana divisions furnished Ward with a substantial tax write-off thereby saving the corporation as a whole a substantial amount in taxes. Also a portion of Ward's short-term investment income was attributable to funds generated in Montana.

Since Ward's operation in Montana was both dependent upon and contributory to its operation outside the state, the Montana ranch divisions were part of Ward's unitary business during the years in question.

The respondent Ward contends that the DOR's assessment of additional taxes against it in this case is an attempt to subject income earned by Ward in other states to

the Montana corporation license tax in violation of the due process clause of the Fourteenth Amendment of the United States Constitution. We disagree.

The United States Supreme Court recently addressed this issue in *Mobil Oil Corp.*, 445 U.S. at 436-437, stating:

> "It long has been established that the income of a business operating in interstate commerce is not immune from fairly apportioned state taxation. (Cite omitted.) '[T]he entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing instate aspects of interstate affairs.' (Cite omitted.) For a State to tax income generated in interstate commerce, the Due Process Clause of the Fourteenth Amendment imposes two requirements: a 'minimal connection' between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise. (Cite omitted.)"

The "minimal connection" or "nexus" is established "if the corporation avails itself of the 'substantial privilege of carrying on business' within the State . . ." *Mobil Oil Corp.*, 445 U.S. at 437, citing Wisconsin v. J.C. Penny Co. (1940), 311 U.S. 435, 444-445. Ward clearly availed itself of this privilege in Montana.

The "rational relationship" requirement is met in this case also. Ward was operated as a unitary business and as discussed earlier its operation in Montana was both dependent upon and contributory to its operation outside the state. Therefore, the portion of Ward's total income attributed to Montana under Montana's three-factor apportionment formula is rationally related to the intrastate value of the corporation.

The second issue raised by appellant DOR is whether the District Court used the proper standard of review of

STAB's findings and ruling. Since we are reversing the District Court judgment, this issue is irrelevant to a determination of this appeal.

The judgment of the District Court is reversed and the order of the State Tax Appeal Board entered October 1, 1979 in Docket No. CT-1978-3 is reinstated.

FRANK I. HASWELL, Chief Justice

We Concur:
GENE B. DALY
FRED J. WEBER
FRANK B. MORRISON, JR.
JOHN C. SHEEHY
Justices.

No. 44457

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

WARD PAPER BOX COMPANY, a Missouri corporation,
Appellant,

— vs —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Respondent.

JUDGMENT ON REVIEW OF AGENCY ACTION

Filed: August 12, 1980

This matter involved an appeal from an Order of the State Tax Appeal Board entered October 1, 1979, in Docket No. CT-1978-3 and came before this Court on a Petition for Judicial Review by the taxpayer pursuant to Section 2-4-702, MCA, and Section 15-2-303, MCA, containing a statement of facts and specifying the grounds for review, and was filed pursuant to applicable law; and

This Court reviewed the record, heard oral argument of counsel, reviewed the written briefs and after having taken the matter under advisement, did on August 4, 1980, issue its Opinion and Order, a copy of which is attached hereto marked Exhibit "1" and which is by this reference incorporated herein;

NOW, THEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the Order of the State Tax Appeal Board in Docket No. CT-1978-3 be, and it is hereby reversed because the substantial rights of the Appellant taxpayer have been prejudiced as more particularly set

forth in Exhibit "1" and because the decision is clearly erroneous in view of the reliable, probative and substantial evidence on the whole record;

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the case be remanded to the State Tax Appeal Board for further proceedings in accordance with Exhibit "1".

DATED this 12th day of August, 1980.

GORDON R. BENNETT, District Judge

EXHIBIT "1"

No. 44457

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

WARD PAPER BOX COMPANY, a Missouri corporation,
Appellant,

— vs —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Respondent.

OPINION and ORDER

Filed: August 4, 1980

This cause concerned the taxing of income by the State of Montana of Ward Paper Box Company.

It is agreed that the 14th Amendment of the United States Constitution prohibits a state from asserting a tax on income derived from business conducted beyond its border. However a situation arises wherein a corporation operates both within and without the state. In such a situation the legislature has provided one of two methods of taxation. One method is known as "separate accounting" and the other as the formula method.

Under the "separate accounting" method the corporation's activities within an individual state are treated entirely separate from the business activities outside the state.

The "formula" method treats the business activities within the state as part of the over-all business activities carried on by the corporation and considers the business

as "unitary" and apportions the taxable amount generally using three factors of value of property, amount of sales and amount of payroll.

The United States Supreme Court has considered the problem of the state's right to tax multi-state corporate activities but no clear rule has been established. However the formula method has been approved once it is determined that the business is unitary. Montana has by Supreme Court decision approved the formula method, the latest decision being *Department of Revenue v. American Smelting and Refining Company*, __M__, 567 P2d 901.

The question at bench is whether or not the petitioner can be classified as a "unitary operation."

Section 15-31-301 MCA provides the statutory definition of a "unitary" business as follows:

> "...a business is unitary when the operation of the business within the state is dependent upon or contributory to the operation of a business outside the state or if the units of the business within and without the state are closely allied and not capable of separate maintenance as a separate business."

The essential facts of Ward Paper Box's activities within and without the state are as follows:

1. Ward Paper Box Company is a Missouri chartered corporation and has its principal place of business in Kansas City, Kansas.

2. It has qualified to do business in the State of Montana.

3. The corporation is operated by divisions.

4. All out of Montana business concerned the manufacture, sale and distribution of paper boxes and paper box

products in the states of Kansas, Missouri, Colorado, South Carolina and Virginia.

5. The sole Montana activity were two cattle ranch divisions, one in Meagher County and one in Powell County.

6. As to the ranching activities, the resident ranch manager made the day to day decisions but the major decisions such as the purchase of equipment, buying and selling of cattle required the approval of Mr. Lou Ward, Chairman of the Board, or Mr. Don Bowers, the president. The home office in Kansas City, through corporate personnel, made all decisions regarding the financial affairs of all divisions; prepared all federal and state reports (not including motor fuel reports); hired the accountants to prepare tax returns; kept all books; prepared all financial statements and balanced all checkbooks.

7. All divisions had the same operational supervision but there was no joint advertising program, no common salesmen, no common guaranties. Personnel of the various divisions did not move from one division to another, including managing staff. The divisions did not exchange equipment and did not purchase products jointly.

8. Each division had a payroll and expense account maintained in a bank in Kansas City. Whenever moneys were generated by a division they were deposited in the separate division account. If the division did not immediately need the funds, they would be transferred from the separate division's expense account into the Ward Paper Box general account and be utilized wherever needed in any of the separate division operations. The president would make the decisions as to transfer.

The Board of Tax Appeal concluded that there existed a unitary business consisting of two business activities,

namely ranching and paper box activities; that the ranch divisions were dependent on the out of Montana operation; that the ranch divisions were contributory to the operation of the out of Montana operations; that the ranch divisions' operations were closely aligned with the out of state operations; and that the ranch divisions "are not capable of separate maintenance as independent businesses from the operations of activities located outside the state."

The question before this Court is whether or not the business of Ward Paper Box is "unitary" within the meaning of the case law and the Montana statute. There is no essential dispute between the Department and the box company as to the facts of the relationship. The Department characterizes the Montana statutory definition of "unitary" as being composed of three separate tests and if the factual situation meets any one of the tests, the business activity is unitary and that the formula method is appropriate. These tests are (1) dependence, (2) contribution, (3) close alliance and not capable of separate maintenance.

As to the first test, it appears that there is some dependence by the ranch divisions on the out of state activities, although it appears that the ranch divisions could be separately maintained.

As to the second test, there is contribution in that the losses generated by the Montana operations are used by the out of state division for tax purposes and that any funds not used by the ranch divisions, if any, may produce income which could inure to the benefit of the out of state activities.

As to the third test, it appears that there is a close alliance in management and "cash flow" between the ranch divisions and the out of state activities.

The appellant contends that it has the right to make the tax return as it did, namely by separate accounting and that the conclusions of the State Tax Appeal Board are clearly erroneous in that they are not supported by substantial evidence within the meaning of Section 2-4-704 MCA.

As before stated and it is agreed that it is fundamental that a state has no power to impose a tax on income earned outside the state. Where, however, in the instance of an entity operating in more than one state the formula method can be used *if the activities can be classified as "unitary."*

The United States Supreme Court has, in the course of considering the question of unitary activities, used language which is appropriate for the facts considered and which sheds some light on the situation here considered.

In *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, the court held that the out of state income of a business that operates in more than one state is subject to examination by the taxing state only because of "the impossibility of allocating the profits earned by the processes conducted within its borders." (Underlining supplied).

In *Mobile Oil Corporation v. Commissioner of Taxes of Vermont* [sic], 48 U.S. Law Week 4306, the court said:

> "For a state to tax income generated in interstate commerce, the Due Process Clause of the Fourteenth Amendment imposes two requirements: a 'minimal' connection between the interstate activities and the taxing state, and a rational relationship between the income attributed to the state and the interstate values of the enterprise."
>
> "Nor do we find particularly persuasive Mobile's attempt to identify a separate business in its holding company function. So long as dividends from subsidiaries and affil-

> iates reflect profits derived from a functionally integrated enterprise, those dividends are income to the parent earned in a unitary business. One must look principally at the underlying activity not at the form of investment, to determine the propriety of apportionability." (Underlining supplied)
>
> "Where the business activities of the dividend payor have nothing to do with the activities of the recipient State, due process consideration might well preclude apportionability, because there would be no underlying unitary business."

In *Exxon Corp. v. Department of Revenue of Wisconsin* (United States Supreme Court, decided June 10, 1980), the court approved the apportionability of the Wisconsin statutes in a situation where Exxon was vertically integrated with a corporate structure divided into three parts namely Corporate Management, Coordination and Service Management, and Operations Management. The Wisconsin operation consisted of marketing products only. The court reiterated its previous holding that a company's internal accounting techniques are not binding on a state for tax purposes and restated the general rule that the due process clause imposes two requirements for state taxation "a minimal connection or nexus between the interstate activities and the taxing state, and *a rational relationship between the income attributed to the state and the intrastate values of the enterprise.*"

The appellant contends that a fundamental error occurred. It argues that the statutory standard of taxation arises from the words "income derived from or attributable to Montana sources" Section 15-31-101(3) MCA and it is only where necessary that 15-31-301 comes into effect (attribution of income). The appellant contends that the income sought to be taxed must have a Montana source — that is an activity must take place in Montana which contributes to income or upon which the overall

operation depends to produce income in a real way. It points out that the two operations of the tax payer here are separate, they do not share goods, supplies, sales, advertising, machinery, employees, technical assistance. It urges that the only real connections is that the monies originate at the same point and return to the same point which has been referred to as "cash flow."

The factual situation as disclosed by the record demonstrates that there is no impossibility of allocating the income between the Box activities and while there is minimal nexus between Box activities and the ranch activities, there is no real contribution by the ranches to the income of the Box activity.

To preserve the administrative function, the standard of review by the courts has been limited by statute, namely Section 2-4-704 MCA, wherein it states as follows:

> "(2) the court may not substitute its judgment for that of the agency as to the weight of evidence on questions of fact. The court may affirm the decision of the agency or remand the case for further proceedings. The court may reverse or modify the decision if substantial rights of the appellant have been prejudiced because the administrative findings, inferences, conclusions or decisions are:
>
> (a) in violation of constitutional or statutory provision;
> (b) in excess of the statutory authority of the agency;
> (c) made upon unlawful procedure;
> (d) affected by other error of law;
> (e) clearly erroneous in view of the reliable, probative and substantial evidence on the whole record;
> (f) arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion; or
> (g) because findings of fact, upon issues essential to the decision, were not made although requested."

The Montana Supreme Court has in *Brurud v. Judge Moving and Storage Co., Inc.*, 172 M 249 set for the definition of "clearly erroneous" as follows:

> "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed."

The Montana State Board of Tax Appeals has found the business to be unitary and it is the view of this Court that such finding is clearly erroneous. Fundamentally the rationale of the unitary tax concept as approved by the United State Supreme Court directs the look of the court to the "underlying activity not at the form of investment, to determine apportionability." (*Mobile Oil Corporation v. Commissioner of Taxes of Vermont*, supra.) [sic].

In the controversy under consideration here the activities of the appellant which produce income unrelated to the Montana activities, and which the State seeks to tax, are distinctly separate. The contribution of the ranch activity to the income from the paper box activity, if any, is slight.

The position of the State here is an unwarranted extension of the "unitary concept" and violates the basic rationale of the unitary concept.

This Court finds and concludes that the decision of the State Tax Appeal Board is clearly erroneous and therefore should be reversed and remanded to the State Tax Appeal Board for further proceedings in accord with this opinion.

Let judgment be entered accordingly.

Dated this 4th day of August, 1980.

PETER G. MELOY, District Judge

cc to: Counsel of record

Docket No. CT-1978-3

BEFORE THE STATE TAX APPEAL BOARD OF THE STATE OF MONTANA

WARD PAPER BOX COMPANY, a Missouri corporation,
Appellant,

— vs —

THE DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Respondent.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

Hearing on the appeal of Ward Paper Box Company, pursuant to Sections 2-4-601 and 15-2-302, M.C.A., came on regularly for hearing before the Board on April 23, 24, 1979, in the City of Helena, Montana, from a decision of the Department of Revenue denying Appellant's request to set aside the deficiency assessment levied against said Appellant and the decision of the Department of Revenue in treating Appellant as a unitary operation and requiring formula apportionment of all of Appellants income for the taxable years 1971 through 1975, the Appellant, Ward Paper Box Company, appearing through its attorney, Ward A. Shanahan, of the firm of Gough, Shanahan, Johnson & Waterman, Helena, Montana; and the Department of Revenue being represented by Terry B. Cosgrove, Special Assistant Attorney General; and the Board having heard the testimony and have examined all of the evidence and the briefs offered by all parties, and the Board being fully advised in the premises, does hereby make its Findings of Fact, Conclusions of Law and Order as follows:

FINDINGS OF FACT

I.

Ward Paper Box Company is a corporation organized and existing under the laws of the State of Missouri, duly authorized and qualified to do business in the State of Montana with its principal place of business at 3150 Chrysler Road, Kansas City, Kansas. The President of the company, Mr. Don E. Bowers, has his office there.

II.

The company operated in its corporate capacity in Montana and received services from the State of Montana, through its divisions, the Castle Mountain Ranch Division in Meagher County, Montana, which was purchased on December 1, 1969, and the Rock Creek Cattle Company Division in Powell County, Montana, which was purchased on December 1, 1972. These divisions produce livestock, hay, forage and other crops solely in Montana and operate in Montana and no other state.

III.

The corporation also operated several paper box divisions which, during the taxable years in question, manufactured, distributed and sold paper boxes and paper box products in the states of Kansas, Missouri, Colorado, South Carolina and Virginia. During the audit period, none of these divisions in any way engaged in the business of manufacturing, distributing or selling paper boxes or paper box products in the State of Montana or engaged in the business of agriculture or the business of producing livestock, hay, forage or other crops in the state of Montana, or in any other state.

IV.

The Department of Revenue, pursuant to a notice of deficiency, assessed a deficiency against the taxpayer

under the Montana Corporation License Tax for the years 1971, 1972, 1973, 1974 and 1975.

V.

The taxpayer had been filing its returns in the state of Montana utilizing the method of separate accounting.

VI.

The Taxpayer's ranching activities are limited solely to the state of Montana; but said Taxpayer has filed its tax returns in the states of Missouri, Kansas, Colorado, South Carolina and Virginia under the method of unitary apportionment of its total net income, including as a portion of its regular business income, the income and expenses from the ranch activities and apportioning that income to the other states.

VII.

In the "sales factor" of the three-factor formula used by the Department of Revenue, Montana sales of livestock, hay and some gravel are compared with all sales, including sales in other states of paper boxes and paper box products for the taxable years in question.

VIII.

In the "payroll factor" of the three-factor formula used by the Department of Revenue for the taxable years in question, the salaries and benefits paid to ranch supervisors, supervisory personnel and all employees in the state of Montana were compared to all employees of the company everywhere.

IX.

In the "property factor" of the three-factor formula used by the Department of Revenue for the taxable years in question, the property owned and located in the State of Montana is compared to the property owned by the company and located elsewhere.

X.

During the period of the audit, the sales factor representing the Montana sales, equaled the following percentage of the taxpayers total sales: 1971 - 4.9%; 1972 - 1.1%; 1973 - 6.5%; 1974 - 6.6%; and 1975 - 7.3%.

XI.

During the period of the audit, the payroll factor representing the Montana payroll, equaled the following percentages of the taxpayers total payroll: 1971 - 3.2%; 1972 - 5.9%; 1973 - 11.3%; 1974 - 11.7%; and 1975 - 15.5%.

XII.

During the period of the audit, the property factor representing the Montana property, equaled the following percentages of the taxpayers total property: 1971 - 50.6%; 1972 - 64.4%; 1973 - 70.5%; 1974 - 67.3%; and 1975 - 68.1%.

XIII.

The Montana payroll, property and sales during the period of the audit equaled the following percentages of the companys total payroll, property and sales: 1971 - 19.6%; 1972 - 23.8%; 1973 - 29.4%; 1974 - 28.5%; and 1975 - 30.3%.

XIV.

During the years in question, the ranch manager had decision making authority on the day to day ranch operations; however, for matters outside of the day to day activities, including, but not limited to, the purchase of equipment, or buying or selling cattle, such decisions required approval from either Mr. Louis Ward, Chairman of the Board or Mr. Don Bowers, President of the company.

XV.

The home office, located in Kansas City, Missouri, made all decisions regarding the financial affairs of the

corporation, the home office also provided and prepared for all of the divisions including Montana, the federal and state reports (other than motor fuel) which were filed; the home office also hired the accounting firm of Touche and Ross to prepare all federal and state tax returns; the home office also kept all of the books, prepared all financial statements, and balanced all checkbooks. All divisions of the corporation, including the ranch divisions, were charged an arbitrary figure of $60.00 per month for all home office services. This figure was not based upon any allocation of time spent by any of the home office personnel, and had been in use prior to the time of the audit.

XVI.

The Montana divisions could not account for their total actual expenses in as much as an arbitrary $60.00 a month figure is charged for home office services, which bears no relation to the actual time expended, and was allocated throughout the company on that same basis without any regard to what the actual charge should be to a particular division.

XVII.

The Chairman of the Board and principal stockholder, Mr. Louis L. Ward, visited Montana the following listed number of times during the years in question, according to a log kept of the movements by the company aircraft:

1971 — 8 trips to Helena, 1 to Billings
1972 — 12 trips to Helena
1973 — 5 trips to Helena
1974 — 6 trips to Helena
1975 — 6 trips to Helena

XVIII.

A Mr. J. Tschudy was hired by the company as a consultant in ranch properties in 1968. He visited the Castle Mountain Ranch in Meagher County several times. His

permanent office was in Kansas City, Kansas. Mr. Tschudy died in 1972, his compensation was included in wages and salaries claimed as deductions for the Montana ranch operations in 1971 and 1972.

XIX.

During the period of the audit the ranch and box divisions had the same operational supervision, there was no joint advertising program among any of the divisions of the corporation, there were no common salesmen for any of the divisions of the corporation, there were no common guarantees for any of the divisions of the corporation, personnel from the various divisions did not move from one division to another, including managing staff; the various divisions did not exchange equipment; the divisions did not purchase products jointly whether for the ranch or box operations.

XX.

During the period of the audit the ranch personnel consisted of employees working exclusively on specific ranch projects; no accounts, bookkeepers or office employees were employed at either ranch divisions during the period of the audit.

XXI.

Each division had a payroll account and an expense account. The expense accounts were maintained in a bank in Kansas City, and whenever monies were generated by a division they were deposited in the separate division expense account. If the division did not immediately need the funds, they would be transferred from the separate division expense account into the Ward Paper Box general account and be utilized wherever needed in any of the separate division operations. The determination of whether or not funds would be transferred from the divi-

sion expense account to the Ward general account was made by the President of the company.

XXII.

The ranch divisions maintained a payroll account in a Montana bank, however the ranch manager did not know the balance of the account, he merely would write the payroll checks and forward the information to the home office where the records were maintained, the books balanced and deposits originated. The ranch manager would not make deposits in the payroll account, those decisions were made at the home office. Limits on the size of a check a ranch manager could write were set by the Board of Directors of the Company.

XXIII.

During the period of the audit, monies would be transferred from the separate division expense account, including the Montana divisions, to the Ward general account for the purpose of making short term investments.

XXIV.

The investment income earned by the taxpayer, a portion of which was attributable to the funds generated in Montana, was reported only in the State of Missouri, and could not be segregated as to source including that portion attributable to the income generated in Montana.

XXV.

The ranch operations did not generate sufficient cash inflow generated from the company's other operations, during the audit period: 1971 - $752,693.00; 1972 - $4,535,597.00 — this did include $3,300,000.00 for the purchase of the Rock Creek Division, so the actual cash inflow needed apart from the ranch acquisition was $1,235,597.00; 1973 - $938,931.00; 1974 - $1,268,146.00; and 1975 - $819,984.00 [sic].

XXVI.

Funds exceeding those generated from the ranch divisions necessary to pay ranch expenses would be transferred from the Ward general account to the ranch expense account.

XXVII.

Funds from the ranch divisions when transferred to the Ward general account were co-mingled with other funds of the company.

XXVIII.

The taxpayer never requested under the provisions of Section 15-31-312, M.C.A., for the use of a different apportionment formula or for modification of the formula, only for the right to use separate accounting.

XXIX.

The taxpayer has had the opportunity to examine all information utilized by the Department in making its determination of the deficiency assessment.

CONCLUSIONS OF LAW

I.

The taxpayer has income arising from business activities both within and without the state of Montana.

II.

The corporation is engaged in two business activities.

III.

The operation of the ranch divisions within the state is dependent upon the operations of the company located outside the state.

IV.

The operation of the ranch divisions within the state is contributory to the operation of the divisions outside the state.

V.

The operation of the ranch divisions within the state is closely aligned with the operations of the taxpayer located outside the state.

VI.

The operations of the ranch divisions are not capable of separate maintenance as independent businesses from the operations of the activities located outside the state.

VII.

A flow of goods within a corporation is not necessary in order to have a unitary business operation.

VIII.

The taxpayer is operating a unitary business as defined by the statutes and regulations of the Corporation License Tax Act.

IX.

A unitary business is not able to properly separately account for its income or expenses.

X.

The taxpayer cannot properly segregate income or expenses directly attributable to the State of Montana.

XI.

The taxpayer has been improperly filing on the separate accounting basis, and is required to file on the apportionment method, utilizing the factors of payroll, property and sales.

XII.

The Department of Revenue has properly taxed income which is in fact derived from or attributable to Montana sources.

XIII.

The formula utilized by the Department in computing the net income attributable to the taxpayer, is ration-

ally related to the values provided by the state to the taxpayer.

XIV.

The deficiency assessment levied by the Department and its determination that the operations of the taxpayer are unitary, does not exceed the power of the Department to access [sic] and levy a tax pursuant to the laws of the State of Montana, and does not result in a taxation upon income earned in other states, and is not a taking of property without due process of law in violation of either the 5th or 14th Amendments of the Constitution of the United States and the applicable provisions of the Montana Constitution.

XV.

The regulation 42-2.6(1)-S6270, was properly adopted and effective for the years in question.

XVI.

The regulation 42-2.6(1)-S6450 and regulations 42-2.6(1)-S6280 and 42-2.6(1)-S6450 do not exceed the scope of the authority of the Department of Revenue, and were properly adopted and effective for the years in question.

XVII.

The action of the Department of Revenue in no way denies the taxpayer equal protection under the laws guaranteed to it by the 14th Amendment to the Constitution of the United States.

XVIII.

That the method utilized by the taxpayer of filing its corporate returns in other states is relevant to the inquiry of determining in the State of Montana how the taxpayer should be reporting.

XIX.

That the taxpayer has not properly reported its income in accordance with the Montana Corporation License Tax effective for the taxable years in question.

ORDER

Based on the above Findings of Fact and Conclusions of Law, IT IS HEREBY ORDERED:

1. That the taxpayers appeal from the decision of the Department of Revenue is denied.

2. That the Appellant herein pay all Montana Corporation license taxes herein assessed, and interest, as properly imposed by the laws of the State of Montana.

DATED this 1st day of October, 1979.

BY ORDER OF THE STATE TAX APPEAL BOARD

HELEN M. PETERSON, Chairman

ROBERT S. RAUNDAL, Member

JAMES A. STEFFECK, Member

IN THE MATTER OF THE PROTEST OF
WARD PAPER BOX COMPANY

Proposed Deficiency Assessments of
Corporate License Tax For Calendar Years
1971, 1972, 1973, 1974 and 1975

HEARING OFFICER:

John Clark, Administrator, Research Division, Department of Revenue, Mitchell Building, Helena, Montana 59601

DATE OF HEARING:

December 28, 1977, at 10:00 o'clock a.m., continued to April 6, 1978, at 9:00 o'clock a.m.

PLACE OF HEARING:

Mitchell Building, Helena, Montana

PRESENT FOR THE TAXPAYER:

Mr. Ward Shanahan, of Gough, Shanahan, Johnson & Waterman, First National Bank Building, P.O. Box 1686, Helena, Montana 59601

PRESENT FOR THE DEPARTMENT:

Mr. Terry Cosgrove and Mr. Robert Corcoran, Counsel for the Montana Department of Revenue

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The controversy in question arises out of the determinations of Montana Corporate License Tax dated June 1, 1977 concerning Ward Paper Box Company's liability for the years ending December 31, 1971 through December 31, 1975 inclusive. These determinations were based on an audit conducted by staff of the Corporation License Tax Division for the Montana Department of Revenue for the State of Montana.

The foregoing letters of determination disclose the following corporate license tax liability due the State of Montana from Ward Paper Box Company (hereafter Ward) as of May 30, 1977.

	1971	1972	1973	1974	1975
Tax due per audit	$26,045.	$29,690.	$31,167.	$35,532.	$44,770.
Interest at 9%					
5/15/72-5/30/77	11,818.				
5/15/73-5/30/77		10,800.			
5/15/74-5/30/77			8,532.		
5/15/75-5/30/77				6,529.	
5/15/76-5/30/77					4,197.
	$37,863.	$40,490.	$39,699.	$42,061.	$48,967.
GRAND TOTAL	$209,080.				

By letter dated June 29, 1977 received by the Montana Department of Revenue (hereinafter the Department) on June 29, 1977, Mr. Ward A. Shanahan, counsel for Ward, filed a protest against the foregoing determinations and requested an opportunity to have an oral hearing and the right to present additional evidence.

Mr. Shanahan contended that the company operates in Montana through two divisions, Castle Mountain Ranch division and Rock Creek Cattle Company division an agricultural business producing livestock, hay, forage and other crops. Mr. Shanahan further contended that the Paper Box Division is a wholly separate division which did not engage in business in the State of Montana or engage in the business conducted by the divisions in the State of Montana. Further, that the income of the taxpayer from sources within the state is properly segregable; that regulation 42-2.6 (1)-S.6270 was not adopted or effective for the years 1971 and 1972; that the same regulation purports

to adopt a uniform act which has not been adopted by the legislature; that regulations 42-2.6 (1)-S.620 through 42-2.6 (1)-S.6450 exceeded legislative authority and therefore was not effective in the years in question; that the activities of the taxpayer are separate and distinct from the other activities not part of a unitary business and the business conducted within the state is not dependent upon or contributory to the business conducted outside the state; that the elements of common ownership; use of centralized facilities, centralized management and decision making are not sufficient to establish unitary business; and that the actions of the Department exceeded the regulations of the Department, exceed statutory authority and are not based upon sufficient facts and are otherwise arbitrary.

As a result of the protest, an informal conference was held on August 22, 1977, between representatives of Ward and the Corporation License Tax Division at which time it was determined that there was no prospect of a settlement of this matter and the taxpayer by letter dated September 16, 1977 further requested an oral hearing on this matter.

By letter dated November 1, 1977 Mr. Shanahan was notified of the hearing which was subsequently held on December 28, 1977. At the hearing questions were raised as to the propriety of Mr. Foster conducting the informal hearing of this matter and to the nature and procedure of the hearing.

At the hearing the taxpayer agreed to supply tax returns filed in other states in which it operates its box divisions but no cattle operations, and filed an additional protest of the proposed action of the Corporation License Tax Division.

The hearing was adjourned until a further date.

By letter dated March 15, 1978 Mr. Shanahan was informed that the hearing would be reconvened but that due to the allegation that Mr. Foster could not properly hear this matter, Mr. John Clark, Administrator, Research Division, was appointed as the informal hearings officer.

The hearing was reconvened on April 6th at 9:00 o'clock at which time the taxpayer was given the opportunity to present any additional information relating to the proposed deficiency.

During the foregoing proceedings, Ward has been given every opportunity to produce any documents or other evidence it wished to have considered in conjunction with the hearing. The department relied on the materials submitted by the taxpayer to resolve the questions at issue at the hearing.

It is important to again review the nature of the hearing contemplated by section 84-1508.1. This question was specifically raised and decided by the Montana Supreme Court in the case of *W.R. Grace and Co., vs. the Department of Revenue of the State of Montana*, 34 St. Rep. 713, __P2d__ (1977). There the Montana Supreme Court very clearly defined the scope and extent of this hearing when it said:

> "As stated above, Section 84-1508.1 does not provide a true adversary hearing, but only for a presentation of additional evidence by the taxpayer and a reconsideration by DOR thereafter." Page 716.

Under this mandate from the Supreme Court of Montana, it is necessary then to weigh the additional information provided by the taxpayer to determine if there is just cause for a reconsideration of the proposed assessment.

The taxpayer has not questioned the calculations of the Department in proposing the deficiency assessment but

has limited its arguments solely to the legal authority of the Department to require the taxpayer to file a unitary tax return.

The authority of the Department to require the filing of a unitary tax return is derived in Section 84-1503 R.C.M. 1947 and the regulations adopted by the Department. Under the statute 84-1503, prior to its amendment in 1974, a corporation was required to file its returns based on the separate accounting method only if, "the income of any corporation from sources within the state cannot be *properly* segregated from income without the state". To determine whether a corporation can properly separately account, it is necessary to look at the regulations which were in effect prior to the 1974 amendment. These provide that any corporation which conducts a unitary business within and without the State of Montana must apportion its business income. The regulations further provide that "a business is unitary when the operation of the business within the state is *dependent upon*. . . the operation of the business outside the state". That language was subsequently enacted into the amended section of 84-1503.

Whether or not those regulations were valid was decided by the Supreme Court of Montana in the case of *Montana Department of Revenue vs. American Smelting and Refining Company*, 34 St. Rep. 597, __P2d__ (1977), wherein the Court stated:

> "The crux of this entire case is the interpretation of Section 84-1503 and DOR regulations 1001-1020. There is no merit in ASARCO's contention that DOR has only authority to adopt rules and regulations for the apportionment of income incapable of segregation as to source."

The entire question then of the validity of the audit rests upon a determination of whether or not the taxpayer is

conducting a unitary business. If the taxpayer is conducting a unitary business as defined by the regulations adopted by the Department prior to 1974 and by the legislative enactment thereafter, then the taxpayer must file using the unitary method. The taxpayer in its protest claimed that it could separately account and that the Department did not question that it could so separately account. The Department specifically denies the taxpayer can properly separately account. The taxpayer may try to maintain separate books and records, but such is not sufficient under the statute or regulations.

Are then the business activities of the taxpayer within the State of Montana dependent upon the operations of the taxpayer outside the State of Montana? Traditionally there have been two tests utilized for the determination of whether or not a corporation operates a unitary business. The first test is a determination of the existence of the three unities (unity of ownership, unity of operation and unity in a centralized executive force) which was used in the case of *Butler Bros. vs. McColgan*, 315 U.S. 501, (1942) and relied upon by the taxpayer. However, the test embodied by the regulations and statutes involved herein, is the contribution or dependency test as used in *Edison, California vs. McColgan*, 183 P2d 16 (1947). In what ways then are the activities of the cattle operations in Montana dependent upon the general manufacturing operation?

Consider the following facts. Supervision of the cattle operation is conducted by Mr. Lewis Ward, President of Ward Paper Co. who determines the size of herds, oversees cattle purchases, negotiates land purchases and has final approval on all major cattle purchases. Construction of any facilities in the Montana operation require prior approval from the home office. Purchases of any equipment

require prior approval from the home office. Whether or not feed for the cattle will be purchased and how the land is to be utilized rests with final approval of Mr. Ward. All major ranch expenses are approved at the home office. Ranch managers are limited as to the checks which can be written on various ranch accounts; they are given a fixed number of blank checks with which to work. Generally, ranch supplies are ordered and billed directly to the home office. The home office provides payments for all farm vehicle insurance on ranch properties. Capital with which the ranches were purchased was provided by stock dividends in the Russell Stover Candy Company owned by the taxpayer. Operating capital is provided by the taxpayer since the ranch divisions have continued to sustain operating losses. Home office personnel and accountants in Kansas City prepare federal tax returns, financial statements, fuel tax reports, U.C.C. reports, workman's compensation reports and payroll data. Although ranch managers sign the payroll checks, the checks are prepared from the home office. The home office prepares the books and handles payroll for the ranch operations. Each ranch division is allocated an arbitrary overhead charge of $60.00 per month for general and administrative costs, but allocation is not based on hours spent. Insurance for the ranch properties is arranged by the home office through a national agent.

There appears no doubt that the operations of the ranch division are highly dependent on the operations of the home office. Strong centralized management is indicative of a unitary operation. When, as here, there is strong central management in conjunction with the centralization of functions such as financing, accounting, research and purchasing, it is indicative of a single unitary business. It is true that in this case there is no intercompany flow of goods but such a requirement is not absolutely necessary

if the other elements of a unitary business are present. *Superior Oil Co. vs. Franchise Tax Board*, 386 P2d 33, *Honolulu Oil Co. vs. Franchise Tax Board*, 386 P2d 40 (1963). In *Zale - Salem Inc. vs. State Tax Commission*, 391 P2d 601 (1964) the Supreme Court of Oregon found that a unitary business was present when a parent corporation provided the following services for its wholly owned subsidiaries: central buying and manufacturing; central management, accounting, advertising, legal and other services; strict accounting, management control and supervision; paychecks and other disbursements handled by central office; control over personnel including the hiring, training and firing; requirement that the manager of each local corporation submit a daily accounting; all monies received deposited in a local bank and can only be withdrawn by officers of the parent; financial and management interests of the separate corporations conducted by the parent. That case involved a situation dealing with a parent and subsidiary corporations operating in one unitary framework, however, the principals are applicable when separate divisions of a corporation operate within the same framework as is in the present situation.

In addition, the taxpayer provided copies of its state income tax returns filed in the states of Kansas, Missouri and Colorado showing that in those states it is filing on the unitary method claiming the cattle division as a portion of the unitary activities of the corporation, when by the taxpayers own admission, there were no cattle operations conducted in those states.

CONCLUSION

For the reasons herein stated, it is the determination of the Department, after reconsideration, that the assessments proposed in the determination letter of May 30, 1977 are correct.

Respectfully submitted.
JOHN CLARK, Hearing Officer

APPENDIX B

Cause No. 44457

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

WARD PAPER BOX COMPANY, a Missouri corporation,
Appellant,

— v. —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Respondent.

STIPULATION FOR STAY, JUDGMENT AND EXECUTION

COME NOW the parties, pursuant to Montana Rules of Civil Procedure and the Montana Rules of Appellate Civil Procedure, and stipulate as follows:

I

That Respondent and Appellant Ward Paper Box Company recovered a judgment in this court in this action which was appealed to the Montana Supreme Court by The Department of Revenue of the State of Montana. That the judgment was reversed by the Order of the Supreme Court in Docket No. 80-375 and remittitur was returned to this court on or about January 25, 1982, following denial of petition for rehearing; and

II

That Respondent and Appellant taxpayer Ward Paper Box Company raised constitutional issues and federal questions related thereto in this proceeding before the State Tax Appeal Board, this court and the Supreme Court

of Montana, and the taxpayer has advised the Department of Revenue it intends to file an appeal and make application for writ of certiorari pursuant to 28 U.S.C. and the Rules of the Supreme Court of the United States and would be entitled to stay entry of judgment herein and to stay the issuance of a writ of execution for the tax liability due pursuant to Fed. R. Civ. P. 50-51 pending lodging of an appeal or application for the writ of certiorari, but Department of Revenue is satisfied ample security is present within the jurisdiction against which the department could enforce its judgment and recover tax and interest due and, therefore;

III

IT IS HEREBY STIPULATED that the entry of judgment on remittitur and issuance of levy of execution pursuant thereto will be considered stayed pending the expiration of time allowed in filing an appeal and making application for writ of certiorari to the Supreme Court of the United States with respect to the constitutional issues and federal questions raised in this matter.

DATED this 2 day of February, 1982.

GOUGH, SHANAHAN, JOHNSON & WATERMAN

Ward A. Shanahan
Attorneys for Ward Paper Box Company
301 First National Bank Building
P.O. Box 1715
Helena, MT 59624-1715

DEPARTMENT OF REVENUE, STATE OF MONTANA

By: Terry B. Cosgrove
Special Assistant Attorney General
P.O. Box 1144
Helena, MT 59624-1144

ORDER

The Court having viewed the foregoing stipulation, the Montana Rules of Civil Procedure and the Rules of Appellate Civil Procedure and, in particular, Rule 7 thereof, and being duly advised in the premises, does hereby;

ORDER that entry of final judgment in this matter and issuance of stay thereon be, and they are hereby stayed pending application for Appeal or Writ of Certiari to the Supreme Court of the United States with respect to the constitutional issues and federal questions raised herein [sic].

DATED this 2 day of February, 1982.

PETER MELOY, District Judge

80-375

D.C. No. 44457

IN THE SUPREME COURT OF THE
STATE OF MONTANA
June Term A.D. 1981

Filed: 82 Jan 18

The Chief Justice of the Supreme Court of the State of Montana:

To the Honorable Judge of the District Court of the First Judicial District, in and for the County of Lewis and Clark. Greeting:

WHEREAS, In the said District Court in a cause between Ward Paper Box Company et al., Respondent and Appellant and Department of Revenue of the State of Montana, Appellant and Respondent wherein the judgment of the said District Court, entered in said cause on the 12th day of August A.D. 1980 was in favor of the said Respondent and Appellant and against the said Appellant and Respondent as by the inspection of the transcript of the record of said Court in said cause which was brought into the Supreme Court of said State by virtue of an appeal, agreeably to the statute of said State and the rules of said Supreme Court in such case made and provided, fully and at large appears.

AND WHEREAS, in the June term of court in the year of our Lord, one thousand nine hundred and eight-one said cause came on to be heard before said Supreme Court and was argued by counsel.

WHEREUPON, On consideration, it is now here ordered and adjudged by this Court that the judgment of the Court below, entered in this cause on the 12th day of

August A.D. 1980 is reversed and the order of the State Tax Appeal Board entered October 1, 1979 in Docket No CT-1978-3 is reinstated.

Costs in this Court:

Appellant	Appearance -	$ None
Respondent	Appearance -	$ 10.00
Remittitur	————————	$ None

December 21 A.D. 1981

You, THEREFORE, are hereby commanded that such further proceedings be had in said cause as, according to right and justice, and the laws of the State of Montana ought to be had, not inconsistent with the opinion hereto attached.

WITNESS: The Honorable Frank I. Haswell, Chief Justice of the Supreme Court of the State of Montana, this 14th day of January A.D. 1981

RICHARD T. CONBOY
Deputy Clerk of the Supreme Court of the State of Montana

No. 80-375

IN THE SUPREME COURT OF THE
STATE OF MONTANA

WARD PAPER BOX COMPANY, a Missouri
Corporation,
Respondent and Appellant

— vs. —

DEPARTMENT OF REVENUE OF THE STATE
OF MONTANA,
Appellant and Respondent.

ORDER

Filed: Jan 14, 1982

PER CURIAM:

The petition for rehearing is denied.

DATED this 14th day of January, 1982.

FRANK I. HASWELL, Chief Justice
JOHN CONWAY HARRISON
JOHN C. SHEEHY
FRANK B. MORRISON, JR.
FRED J. WEBER
Justices

APPENDIX C

Cause No. 44457

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

RUSSELL STOVER CANDIES, INC., a Missouri corporation,

Respondent and Appellant,

— v. —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA.

Appellant and Respondent.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Filed: March 19, 1982

Notice is hereby given that Russell Stover Candies, Inc., the Respondent above named, hereby appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of Montana, ordering judgment in favor of the Appellant, entered in this action on December 21, 1981.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Dated this 19th day of March, 1982.

GOUGH, SHANAHAN, JOHNSON & WATERMAN

Ward A. Shanahan
Attorneys for Respondent and Appellant
301 First National Bank Building
P.O. Box 1715
Helena, MT 59624-1715

CERTIFICATE OF SERVICE

I, Ward A. Shanahan, one of the attorneys for Russell Stover Candies, Inc., the Respondent and Appellant in the above-entitled action, do hereby certify a copy of the foregoing Notice of Appeal to the Supreme Court of the United States was mailed, postage fully prepaid thereon at Helena, Montana, on the 19th day of March, 1982, and directed to the attorneys listed below; and do further certify that all parties required to be served have been served:

Mr. Terry B. Cosgrove
Special Assistant Attorney General
The Montana Club Building
P.O. Box 1144
Helena, MT 59624-1144

WARD A. SHANAHAN

No. 80-375

IN THE SUPREME COURT OF THE STATE OF MONTANA

RUSSELL STOVER CANDIES, INC., a Missouri corporation,

Respondent and Appellant,

— v. —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA.

Appellant and Respondent.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Filed: March 19, 1982

Notice is hereby given that Russell Stover Candies, Inc., the Respondent above named, hereby appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of Montana, ordering judgment in favor of the Appellant, entered in this action on December 21, 1981.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Dated this 19th day of March, 1982.

GOUGH, SHANAHAN, JOHNSON & WATERMAN

Ward A. Shanahan
Attorneys for Respondent and Appellant
301 First National Bank Building
P.O. Box 1715
Helena, MT 59624-1715

CERTIFICATE OF SERVICE

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Special Assistant Attorney General
The Montana Club Building
P.O. Box 1144
Helena, MT 59624-1144

WARD A. SHANAHAN

APPENDIX D

Cause No. 44457

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

WARD PAPER BOX COMPANY,

Plaintiff,

— v. —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA.

Defendant.

MOTION FOR SUBSTITUTION OF PARTIES

COME NOW, Russell Stover Candies, Inc., a Missouri corporation, by and through its counsel, Ward A. Shanahan of the firm of Gough, Shanahan, Johnson & Waterman, pursuant to M. R. Civ. P. 25(c) and moves this Court for an order directing the substitution of Russell Stover Candies, Inc., a Missouri corporation, for Plaintiff, Ward Paper Box Company. This motion is made upon the grounds and for the reasons that Ward Paper Box Company has been merged into Russell Stover Candies, Inc., and the surviving corporation, Russell Stover Candies, Inc., has succeeded to all the interests of Ward Paper Box Company.

Counsel for Defendant, Department of Revenue, has been informed of this motion, has no objection to the granting of the motion and has filed a waiver of hearing of this motion.

Dated this 19th day of March, 1982.

GOUGH, SHANAHAN, JOHNSON & WATERMAN

Ward A. Shanahan
Attorneys for Respondent and Appellant
301 First National Bank Building
P.O. Box 1715
Helena, MT 59624-1715

ORDER

Upon Motion of counsel for Plaintiff, Ward Paper Box Company,

IT IS HEREBY ORDERED that Russell Stover Candies, Inc., a Missouri corporation, having succeeded to the interests of Ward Paper Box Company, be substituted as Plaintiff in the above-entitled action, which shall henceforth be styled, "Russell Stover Candies, Inc., a Missouri corporation, Plaintiff, v. Department of Revenue of the State of Montana, Defendant."

Dated this 19th day of March, 1982.

PETER G. MELOY, District Judge

Motion to Dismiss or Affirm

FILED
JUL 8 82
CLERK

In the Supreme Court

of the United States

OCTOBER TERM, 1981

No. 81-2080

RUSSELL STOVER CANDIES, INC., a Missouri corporation,
Appellant,

vs.

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,
Appellee.

Appeal from the Supreme Court of the State of Montana

MOTION TO DISMISS APPEAL

Terry B. Cosgrove
4th Floor, Montana Club Bldg.
P.O. Box 1144
Helena, Montana 59624

Michael J. Bieley
Montana Department of Revenue
Mitchell Building
Helena, Montana 59620

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In the Supreme Court

of the United States

OCTOBER TERM, 1981

No. 81-2080

RUSSELL STOVER CANDIES, INC., a Missouri corporation, *Appellant*,

vs.

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA, *Appellee*.

Appeal from the Supreme Court of the State of Montana

MOTION TO DISMISS APPEAL

Appellee moves the Court to dismiss the appeal herein on the following grounds:

I.

APPELLANT HAS NOT PRESENTED ANY SUBSTANTIAL FEDERAL QUESTIONS WORTHY OF REVIEW BY THIS COURT.

Two questions relating to the proper function of state income tax laws are raised in Appellant's Jurisdictional Statement under the heading "Reasons for Noting Jurisdiction" at page 8. Appellee will demonstrate that a review of the questions will indicate that this Court should

dismiss this appeal as raising no substantial federal questions worthy of review. U.S. Supreme Court rule 16(1)(b).

A. THE OPERATIONS OF THE APPELLANT CONSTITUTE A UNITARY BUSINESS OPERATION WITHIN CONSTITUTIONAL GUIDELINES.

Appellant's argument beginning on page 9 of the Jurisdictional Statement is in essence that its corporate operations do not constitute a unitary business.

What the Appellant has done in its brief and argument is to glibly review the operations of the company in support of its conclusion that it is not a unitary business. A careful review of those operations in light of the Montana statutory definition of a unitary business, clearly indicates that the operations of Appellant as actually conducted during the period of the audit, fall within the definition of a unitary business operation.

Both parties agree as to certain basic principles which this court has set forth to guide individual states in taxing corporations operating in interstate commerce. Most recently, in *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 at 219, (1980), this Court discussed the proper method of state taxation of multistate business:

> It has long been settled that "the entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs".

For such taxation to be constitutionally permissible, the Due Process Clause of the Fourteenth Amendment imposes two requirements: a minimal connection or nexus between the interstate activities and the taxing state, and a rational relationship between the income attributed to the state and the interstate values of the enterprise. *Exxon Corp. v. Wisconsin*, 447 U.S. at 219, 220, *Mobile Oil*

Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980), *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978).

Nexus is established if the corporation "avails itself of the substantial privilege of carrying on business within the state". *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. at 220. Here there can be no question that the test is met. The Appellant is operating in its corporate capacity within the State of Montana and thereby availing itself of the protection and services provided by the state. *Commonwealth Edison Co. v. Montana*, __ U.S. __, 69 L.Ed. 2d 884 (1981). As to the second test, there is a clear, rational relationship between the income attributed to the state and the interstate values of the operation due to the fact that Appellant is operating as a unitary business within and without the state. Once a finding is made that a company is unitary, then formulary apportionment of its business income is a constitutionally permissible method of measuring the relationship between the income attributed to Montana, as compared to the values provided to the corporation.

> If a company is a unitary business, then a State may apply an apportionment formula to the taxpayer's total income in order to obtain a "rough approximation" of the corporate income that is "reasonably related to the activities conducted within the taxing State".

Exxon Corp. v. Wisconsin Department of Revenue, 447 U.S. at 223.

Appellant has argued that its Montana divisions constitute an unrelated business activity separate from the rest of the corporation. A close review of the Appellant's operational methods indicates the contrary.

Montana's statutory definition of a unitary business, Section 15-31-301(2) M.C.A. is as follows:

> A corporation engaged in a unitary business within and without Montana must apportion its business income as provided for under 15-31-305. A business is unitary when the operation of the business within the state is dependent upon or contributory to the operation of the business outside the state or if the units of the business within and without the state are closely allied and not capable of separate maintenance as independent businesses.

This definition is applicable throughout the entire period of the audit. *Montana Department of Revenue v. American Smelting and Refining Company*, 173 Mont. 316, 567 P.2d 901 (1977), appeal dismissed, 434 U.S. 1042 (1978). The Wisconsin Supreme Court, in the state proceedings in the *Exxon* case, utilized this same test:

> "[T]he essential test is whether or not the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside the state. If there is such a relationship the business is unitary."

Wisconsin Department of Revenue v. Exxon Corporation, 90 Wis. 2d 700, 281 N.W.2d 94, 100, (1979).

Contrary to the position taken by Appellant in its Jurisdictional Statement, the operations of the Appellant within Montana were dependent upon or contributory to the operation of the company located outside of Montana.

At the very crux of this case is the determination of what constitutes a unitary business. It is true that most of the previous cases before this Court regarding this question have dealt with factual situations involving either manufacturing corporations, *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920); general merchandising businesses, *Butler Brothers v. McColgan*, 315 U.S. 501 (1942); distributors, *Bass, Ratcliff and Gretton v. State Tax Commission*, 266 U.S. 271 (1924); or integrated oil companies, *Exxon Corp. v. Wisconsin Department of*

Revenue, 447 U.S. 207, *Mobile Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425. This factual situation presents a case somewhat unique in that it involves the activities of a company operating in more than one type of business. However, the conduct and operation of Appellant's entire business was handled in such a way that it falls within the unitary business test.

This Court has never held that a unitary business must involve the manufacture, sale, or production of the same product. What must be established is that the functional departments, divisions or separate corporations in the case of a combined return (*Edison California Stores v. McColgan*, 183 P.2d 16 (1947), are dependent upon or contributory to each other. In this case, notwithstanding the difference in products, the divisions operating in Montana were clearly dependent upon or contributory to the operations located outside of the state, because of the overall method of operation.

It must be understood that this corporation is not a highly integrated company which acquired an unrelated business investment in Montana. What is present is a group of seven divisions, five in the box business, two in the cattle business, all of which were managed in the same basic manner, whose financial affairs were handled in the same basic manner, but which happen to produce different products. The Appellant has characterized the ruling of the Montana Supreme Court as extending the unitary concept to the point that if the normal incidents of ownership are exercised by a taxpayer then it is de facto a unitary business. But when viewing the divisions' operations, the activities of the Appellant constitute more than merely exercising the incidents of ownership.

General management decisions for all divisions were made at the home office. All funds generated by any divi-

sion were comingled and utilized for whatever needs of the corporation. The ranch divisions were staffed so that they simply could not operate without the services provided by the home office. These operations cannot be considered "discreet business enterprises", as Appellant suggests, when they are managed, handled, and funded in the identical manner as all other divisions of the corporation. Integration of a product line, an intercompany flow of goods, or close functional integration of each arm of the business, have never been essential elements of unitariness. What must be proven is whether or not there is contribution or dependence as required by the statute. Such contribution or dependence can be established from such factors as the levels at which major policy matters are established, or the type of services, including financing, accounting, legal, insurance, purchasing, or other services which are provided to the local operations. *W.R. Grace & Company v. Commissioner of Revenue*, 393 N.E.2d 330 (1979), *Superior Oil Company v. Franchise Tax Board*, 386 P.2d 33 (1963), *Honolulu Oil Company v. Franchise Tax Board*, 386 P.2d 40 (1963), *Department of Taxation v. Lucky Stores, Inc.*, 225 S.E.2d 870 (1976), *Montana Department of Revenue v. American Smelting and Refining Company*, 173 Mont. 316, 567 P.2d 901, appeal dismissed, 434 U.S. 1042, and *Chase Brass and Copper Co., Inc. v. Franchise Tax Board*, 7 Cal. App. 3d 99, appeal dismissed, 400 U.S. 961 (1970).

When a local instate division cannot operate without relying on the out of state home office for anything other than the most routine management decisions; centralized services, including such simple things as balancing of checkbooks, making bank deposits, paying bills; or the influx of capital generated by other divisions of the corporation to meet its basic cash needs, it is inconceivable to say that the local operation is not dependent upon the opera-

tions of the business conducted in other states. When a division is so entertwined with the general overall operations of the company, as in this factual situation notwithstanding that it produces a different product, it cannot be said that it constitutes an "unrelated business activity".

The treatment afforded by Appellant of the Montana operations in the other states in which it was required to file state income tax returns must also be noted. As the Court is aware under the provisions of the Uniform Division of Income for Tax Purposes Act (UDIPTA) a corporation is only required to apportion its "business income" in the various states in which it conducts a unitary business. Income arising from activities and transactions occuring outside the business operation of the taxpayer is allocated generally either to the state of commercial domicile, or the state where the asset is located. Section 15-31-304 M.C.A. Consistent therewith, Appellant treated all interest income as "non-business income", because in the opinion of the accountant for the Appellant, the corporation was not in the business of earning interest income but was in the paper box business and therefore such income was not generated from transactions or activities in the regular course of the taxpayer's trade or business and should be allocated solely to the state of its commercial domicile. However, such treatment was not afforded to the Montana divisions as noted in the Montana Supreme Court opinion (App. Jur. St. page 3). The Appellant filed its tax returns in every other state in which it was operating under the unitary apportionment method including therein the operations of the ranch divisions. In one instance the Appellant indicated investment income was not apportionable because it was not a part of the taxpayer's trade or business. If, as Appellant has argued, the Montana divisions were an "unrelated business investment" and not part of its regular trade or business, then income arising

from the Montana operations should have been treated as "nonbusiness income". However, Appellant's tax treatment of the ranch divisions is not consistent with that position. In fact, Appellant included the ranch divisions as part of its regular trade or business in every state, except Montana, in which it operated. Upon questioning, the auditor for Appellant admitted that the reason for such treatment of the ranch operations was because they in fact constituted a portion of Appellant's regular trade or business operation.

The Montana divisions were not an unrelated business investment but were in fact an expansion of its business. From an accounting, managerial, and financial standpoint all divisions, whether it be box or cattle, operated essentially in the same way. The Montana Supreme Court in reviewing the facts concerning how Appellant operated, found specifically that it met the approved unitariness definition. A corporation which benefits from an umbrella of centralized management and controlled interaction, constitutes a unitary business.

B. HAS THE USE OF THE THREE FACTOR FORMULA VIOLATED CONSTITUTIONAL GUIDELINES FOR APPORTIONMENT OF INCOME.

Issue II raised by Appellant argues that the use of the three factor formula has produced apportionment which is "all out of appropriate proportion to the business transacted by Appellant in Montana." Jurisdictional Statement page 14. It is admitted by the Appellee that if a corporation operating both within and without the state is not conducting a unitary business, a state could not constitutionally levy a tax which would include property or values not found within the taxing state. Once however a corporation is found to be operating as a unitary business, then the use of formulary apportionment has been ap-

proved, as long as the formula itself is not inherently arbitrary. In *Moorman Mfg. Co. v. Bair*, 437 U.S. at 274, this rationale was set forth:

> Underwood contended that the formula taxed "income arising from business conducted beyond the boundaries of the State" in violation of the Due Process Clause. (Citation omitted)
>
> Rejecting this claim, the Court noted that Connecticut "adopted a method of apportionment which, for all that appears in this record, reached, and was meant to reach, only the profits earned within the State," (Citation omitted) and held that the taxpayer had failed to carry its burden of proving that "the method of apportionment adopted by the State was inherently arbitrary, or that its application to this corporation produced an unreasonable result."

This Court has held that an apportionment formula is and cannot be expected to be exact due to the inherent problems a state has in attempting to place upon a business extending into several states "its fair share of the burden of taxation", especially when faced with the impossibility of allocating specifically profits earned within its borders, *Butler Brothers v. McColgan*, 315 U.S. at 507. Such simply is the inherent problem with a unitary operation.

Appellant has cited extensively from the case *Hans Reese Sons v. North Carolina ex. rel. Maxwell*, 283 U.S. 123 (1931), wherein this Court struck down a single factor formula on the grounds that the average income having its source within North Carolina was 17%, while under the assessment method it was allocated 80% of the income. Based on that record this Court found that the operation of the tax was unreasonable and arbitrary. Appellant is attempting to make the same argument here stating that sales of the ranch division constituted only 1% to 7% of

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the company's total sales while the application of the formula allocated 19% to 30% of the corporation's income to Montana.

Appellant is arguing that the only proper way of measuring income reasonably attributable to a state is by use of one factor, i.e., sales alone. Appellant would give no value to the other apportionment factors, property and payroll, which go into the formula. This Court is well aware that sales is not the only method of determining the amount of income reasonably attributed to a state but is only one component which must be measured along with the other components. For example, in the payroll factor, Montana's payroll to overall company payroll ran from 3.2% in the first year of the audit 1971, but steadily grew and for the last three years equaled approximately 11%, 11.7% and 15.5% respectively, of the overall payroll of the corporation. The property located in Montana, ranged from 50% to a high of 70.5% of all the property owned by the corporation. The use of a formula acknowledges that more goes into the generation of income, and the proper apportionment of that income, than merely looking solely at a single factor, i.e. sales. In *General Motors Corp. v. District of Columbia*, 380 U.S. 553 (1965) although not decided on constitutional grounds, this Court discussed the prevalence of the three factor formula by the majority of states requiring payment of such taxes, and concluded that the utilization of such a formula tends to eliminate the possibility of multiple taxation of corporate net income by states using formulas based on one or two factors. "The standard three-factor formula can be justified as a rough, practical approximation of the distribution of either a corporation's sources of income or the social costs which it generates." *General Motors Corp.* at 561.

Appellant is equating solely the value of the Montana divisions in relation to the sales they generate. Jurisdic-

tional Statement page 17. It is in effect saying that the other assets of the corporation, which include 60% of the real property it owns, have no functional value in the overall unitary operation and are to be given no weight in the apportionment formula. This is in spite of the fact that in the other states where the Appellant files its returns on the unitary basis, it includes therein the Montana operations as part of the apportionment formula. Appellant argues that the tax attributable to Montana is all out of proportion to its activities in Montana, yet Appellant includes in its apportionment factors for every other state all of the property, payroll, and sales generated by the Montana activities. It is also interesting to note Appellant has not argued overtaxation among the various states in which it does business, because if all states utilize the same formula the risk of duplication of taxation by two states is avoided. *Moorman Mfg. Company v. Bair*, 437 U.S. at 277. Here the use of a formula including property, payroll, and sales for determining what pro rata share of income is attributable to activities carried on within the State of Montana is not in violation of the precepts of the Fourteenth Amendment.

This issue raised by the Appellant has been dealt with previously by this Court. Utilization of the three factor formula of the income of a unitary business has been consistently approved. The action of the Montana Supreme Court is consistent with this Court's previous holding in *Butler Brothers v. McColgan*, 315 U.S. at 509.

> We cannot say that property, payroll, and sales are inappropriate ingredients of an apportionment formula. We agree with the Supreme Court of California that these factors may properly be deemed to reflect "the relative contribution of the activities in the various states to the production of the total unitary income", so as to allocate to California its just proportion of the profits earned by Ap-

> pellant from this unitary business. And no showing has been made that income unconnected with the unitary business has been used in the formula.

Appellant is a unitary business. The Montana apportionment factors include payroll, property, and sales which are a part of this unitary operation. In *Butler Brothers*, as in this instance, only factors connected with the unitary business have been used in the formula.

In addition, this Court recently ruled that the Due Process Clause does not require an exact measurement of the tax collected as to the services provided by the taxing state. *Commonwealth Edison Co. v. Montana*, __ U.S. __, 69 L.Ed. 2d at 897, 898.

> Moreover, there is no requirement under the Due Process Clause that the amount of general revenue taxes collected from a particular activity must be reasonably related to the value of the services provided to the activity. Instead, our consistent rule has been:
>
> "Nothing is more familiar in taxation than the imposition of a tax upon a class or upon individuals who enjoy no direct benefit from its expenditure, and who are not responsible for the condition to be remedied.
>
> "A tax is not an assessment of benefits. It is, as we have said, a means of distributing the burden of the cost of government. The only benefit to which the taxpayer is constitutionally entitled is that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes. Any other view would preclude the levying of taxes except as they are used to compensate for the burden on those who pay them, and would involve abandonment of the most fundamental principle of government — that it exists primarily to provide for the common good." (Citations omitted).

Appellant has therefore raised no argument which invalidates this tax under the Due Process Clause of the Fourteenth Amendment.

CONCLUSION

Appellant's issues have been dealt with previously by this Court, the action of the Supreme Court of Montana is fully consistent with this Court's decisions, therefore no substantial federal question has been raised and Appellee's Motion to Dismiss should be granted.

Respectfully submitted,

Terry B. Cosgrove
Special Assistant Attorney General
P.O. Box 1144
Helena, Montana 59624

Michael J. Rieley
Special Assistant Attorney General
Mitchell Building
Helena, Montana 59620

Appellant's Reply Brief

Office - Supreme Court, U.S.
FILED
JUL 28 1982
ALEXANDER L. STEVAS,
CLERK

No. 81-2080

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

RUSSELL STOVER CANDIES, INC.
a Missouri corporation,

Appellant,

— v —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,

Appellee.

On Appeal from the Supreme Court of Montana

BRIEF IN OPPOSITION TO MOTION TO DISMISS APPEAL

WARD A. SHANAHAN
P.O. Box 1715
Helena, MT 59624-1715
(406) 442-8560

Counsel for Appellant

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No. 81-2080

IN THE

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OCTOBER TERM, 1981

RUSSELL STOVER CANDIES, INC.
a Missouri corporation,

Appellant,

— v —

DEPARTMENT OF REVENUE OF THE STATE OF MONTANA,

Appellee.

On Appeal from the Supreme Court of Montana

BRIEF IN OPPOSITION TO MOTION TO DISMISS APPEAL

Appellant submits the following brief in opposition to the Appellee's Motion to Dismiss Appeal.

SUBSTANTIAL FEDERAL QUESTIONS ARE RAISED

Appellee's Motion does not rebut the Appellant's claim that substantial federal questions requiring plenary consideration by this Court are raised in this case.

A. *Constitutional Guidelines Are Violated by Application of the Unitary Business Principle to the Appellant's Business Operations.*

Appellant maintains that the Montana statutory definition of a unitary business as interpreted by the Montana Supreme Court and applied to Appellant violates the Due Process Clause of the Fourteenth Amendment. Its application to the Appellant permits Montana to extend its taxing jurisdiction beyond its borders to activities and income unrelated to that State.

Appellee insists that the Montana statutory definition of a unitary business, as applied here, meets constitutional requirements. That definition requires that instate operations be dependent upon or contributory to the operations of the business outside the State. The recent decisions of this Court clearly demonstrate that the important factor in determining the propriety of application of the unitary business principle is the relation of "business activities" within the taxing state to the taxpayer's "course of activities" outside the state. *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 439 (1980); *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980). In this case, the Appellant's ranching operations within Montana are functionally separate and apart from its box manufacturing, distributing and sales activities in other states. The Appellant has no box manufacturing, distributing or sales activities in Montana. Its ranching divisions operate solely within Montana. Nonetheless, the Montana Supreme Court has interpreted the Montana statute to permit the application of the unitary business principle to the Appellant. This result was reached despite the fact that the Appellant's operations in Montana are not functionally integrated with its business activities outside the state. The unitary business

principle was applied in this instance because there was unity of ownership, provision of some administrative and management services to the Montana operations by the taxpayer's home office, and transfer of funds between the Montana divisions and the taxpayer's home office.

Appellant maintains that these factors alone are not sufficient to permit the application of the unitary business principle to all of the taxpayer's operating divisions. As interpreted and applied, the Montana statute violates the due process restrictions of the United States Constitution.

Recently, this Court has reviewed the unitary business principle in two cases of obvious relevance to this case. In both *F.W. Woolworth Company v. Taxation and Revenue Department of New Mexico*, 50 U.S.L.W. 4957 (1982) and *ASARCO, Inc. v. Idaho State Tax Commission*, 50 U.S.L.W. 4962 (1982), this Court reaffirmed the principles stated earlier in *Mobil* and *Exxon*. Those cases also addressed factors similar to those relied upon by the Appellee herein.

It is important to clearly delineate the factors upon which the Appellee relied in applying the unitary business principle to the Appellant. Appellee, in its Motion to Dismiss Appeal, (hereinafter "Motion") notes them as follows:

1. "General Management decisions for all divisions were made at the home office." Motion, p. 5.

2. "All funds generated by any division were commingled and utilized for whatever needs of the corporation." Motion, p. 5-6.

3. The home office provided centralized services including such things as balancing checkbooks, making bank deposits and paying bills. Motion, p. 6.

4. Capital generated by other divisions of the corporation was used to meet the basic cash needs of the ranching divisions. Motion, p. 6.

Many of these same elements were dealt with in the most recent cases decided by this Court.

1. *Management decisions.* The Appellee maintains the general management decisions for all divisions were made at the home office. Both the Montana State Tax Appeal Board and the State District Court found that the ranch manager made the day-to-day management decisions for the ranch divisions. Major management or financial decisions, such as those involving purchase of equipment, or the buying and selling of cattle, required the approval of a chairman or president of the corporation. (App. Jur. St. pp. 14, 23). In *Woolworth*, this Court dealt with a similar factual situation and found it insufficient to evidence a unitary business. There, the question was whether the dividends received by a domestic corporation, which did business in New Mexico, from subsidiaries operating in foreign countries could be apportioned to New Mexico. The parent and subsidiaries were involved in the same general type of business activity. Major financial decisions of the subsidiaries, such as the amount of dividends to be paid and the creation of substantial debt, had to be approved by the parent corporation. Nonetheless the Court concluded that the subsidiaries were not part of a unitary business. The court found little integration of the business activities or centralization of management of the parent and subsidiaries, and viewed as occasional oversight the parent's control of major financial decisions. *F.W. Woolworth Co. v. Taxation and Revenue Department*, 50 U.S.L.W., at 4960-61.

Similarly, this Court, in *ASARCO*, noted with approval the decision of the Idaho Supreme Court that a wholly-owned subsidiary engaged in an activity unrelated to the parent's business operations, was not a part of a unitary business. There, the parent provided important manage-

ment services to the subsidiary and the parent's direction and approval of the subsidiary's major policy decisions was required. *ASARCO, Inc. v. Idaho State Tax Commission*, 50 U.S.L.W. at 4967, n. 22.

2. *Commingling of funds.* In *Woolworth*, the New Mexico Supreme Court, in finding a unitary business, pointed to the fact that the parent had commingled its dividend income from its foreign subsidiaries with its general funds and used them for general operating purposes. In response, this Court held that such an analysis "subverts the unitary business limitation". *F.W. Woolworth Co. v. Taxation and Revenue Department*, 50 U.S.L.W., at 4950, n. 11. While the Court was dealing there with dividend income from subsidiaries, the principles stated surely apply to fund transfers between divisions of a single corporation.

3. *Provision of centralized services.* In *Woolworth*, the Court, in a footnote, addressed the provision of centralized services by a parent corporation to subsidiaries. There, the parent's published financial statements were prepared on a consolidated basis which included some of its subsidiaries. In finding this insufficient to create a unitary business, the Court quoted with approval from Keesling and Warren, *The Unitary Concept in the Allocation of Income*, 12 Hastings L.J. 42, 52 (1960).

> Central accounting, for instance, may result in some savings, but in most instances the amount is trifling in comparison to the income of the various series of business activities for which the accounting is performed. Alone considered, it is too weak a connecting link to bind into one business, what should be separate businesses.

F.W. Woolworth Co. v. Taxation and Revenue Department, 50 U.S.L.W. at 4961, n. 22.

4. *Provision of capital.* Here, the ranch divisions sustained losses in each of the tax years in question and the corporation was required to cover the losses sustained. This factor is the reverse of the second factor relied upon by the Appellee in that funds, instead of being transferred from the ranching divisions to the home office for commingling with funds from other divisions, were transferred from the home office to the division in order to cover operating expenses. The same observations made in relation to commingling of funds at the level of a parent corporation can surely be made with regard to distribution of funds by a home office to separate business divisions of the corporation. If the use of dividend income for the parent's general operating expenses does not evidence a unitary business, surely the use of a corporation's funds to cover the operating expenses of a division similarly fails to demonstrate the existence of a unitary business.

The Appellee's position, based upon the above factors, that the Appellant's Montana operations form a part of a unitary business, receives no support from the recent cases of this Court. These factors do not evidence a unitary business.

Appellant has not argued, contrary to Appellee's statement on page 7 of the Motion to Dismiss Appeal, that its Montana divisions were "an unrelated business investment". Appellant has maintained that its Montana divisions were discrete business enterprises which were engaged in unrelated business activities and were not functionally integrated with any part of its box divisions operating outside the State of Montana. Appellee's argument concerning "unrelated business investments" and "non-business income" has no relevance to the argument before this Court.

Appellee notes the treatment of Appellant's Montana operations in the income tax returns it filed in other states in which the Appellant operates. In those states, Appellant filed its tax returns under a unitary apportionment method which included the operations of the ranch divisions. As this court has stated, the constitutionality of a state tax should not depend upon the vagaries of another state's tax policy. *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. at 444; *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. at 228-229. The question is whether the Appellant's Montana operations are discrete business enterprises unrelated to those business activities undertaken by Appellant in other states. The evidence is more than sufficient to establish that the activities of the Montana ranching divisions are totally separate and distinct from the operations of the box divisions outside the State of Montana.

B. *Income Apportioned to Montana Is Without a Rational Relationship to the Intrastate Value of the Business.*

Appellee characterizes the Appellant's argument in this regard as contending that the only proper way of measuring income attributable to a taxing State is by use of a sales factor. In so doing Appellee misrepresents Appellant's argument. Appellant is not challenging the validity of a three-factor apportionment formula. However, Appellant does contend, and the decisions of this Court require, that following application of any apportionment formula, the resultant income attributed to a State have a rational relationship to the intrastate values of the taxpayer's business. *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 272-273 (1978).

The Appellant, in arguing that there is no "rational relationship" between the income attributed to Montana and the intrastate values of the Montana operations, has con-

trasted the income attributed to Montana with actual income produced there and with the percentage of sales made in Montana. (Jur.St. pp. 14-18). These approaches to determining the existence of a "rational relationship" have been utilized by this Court. In cases involving income or income-related taxes, this Court has compared income attributed to a taxing State to income actually produced or to the level of income-producing activities within that State. In this way the Court has determined whether the attribution of income to the State demonstrates an appropriate relationship to the business transacted within the State.

Here, a corporation license tax is involved. It is a tax computed on the net income derived from or attributable to Montana sources. Section 15-31-101, MCA. Thus, income-producing activities within the State of Montana are the focus of the statute. In this case, the Appellant's income tax returns, based upon a separate accounting method for the tax years in question, revealed that there was no net income from the Montana ranching operations. Nonetheless, Montana's apportionment formula apportioned to Montana between 19 and 30 percent of the total net income of the corporation. This comparison shows the distortive effect of the formula's application.

This Court, in *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135 (1931), made a similar comparison when it contrasted evidence which demonstrated that between 17 and 21 percent of the taxpayer's income had its source in North Carolina to the North Carolina apportionment of 80 percent of the taxpayer's income to that State. Given this comparison of income actually produced against an attribution of income arrived at by formula, the Court held that the allocation bore no reasonable relationship to the business transacted by the taxpayer in North Carolina.

In this case, when income attributed to Montana is contrasted with the Montana operations' percentage of total sales, a clear distortion is again demonstrated. The sales of the ranch divisions in the tax years in question constituted between one and seven percent of the corporation's total sales. The allocation arrived at by application of the three-factor formula resulted in an attribution to Montana of between 19 and 30 percent of the corporation's net income.

In *Butler Brothers v. McColgan*, 315 U.S. 501 (1942), the Court compared the income attribution resulting from the application of a three-factor formula against the total amount of sales from a distribution house located within the taxing State. There, the Court approved a formula which resulted in an allocation of 8.4 percent of the corporation's net income to California. In the same year, the corporation's sales from its San Francisco distributing house represented 7.8 percent of the Company's total sales.

A similar approach comparing percentage of sales within the state to percentage of income attributed to the state was utilized by the Court in *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. at 227. There, the allocation of income to Wisconsin was .22 percent of the total company net income in the four years in question. During those same four years, Exxon's sales in Wisconsin represented .41 percent of the total company sales.

Appellee complains that Appellant relies solely on one factor to demonstrate the disproportionate nature of its allocation. However, use of the payroll factor reveals again that there is a distortion of income attributed to Montana. In each year of the period in question, the percentage of income attributed to Montana exceeded the Montana percentage of payroll by at least twice. In 1971,

for instance, the percentage of Montana payroll to total payroll was 3.2 percent; in the same year the three-factor formula yielded an attribution of 19.6 percent of total corporate income to Montana. In 1974 the Montana payroll was 11.7 percent of total corporate payroll, yet the three-factor formula attributed 28.6 percent of the corporation's total net income to Montana.

The distortion involved here is obviously caused by the property factor in Montana's formula. The distortion is demonstrated above on the basis of comparisons in the areas of income, sales and payroll. Clearly, extra-territorial values are being taxed as a result of Montana's application of a three-factor formula to Appellant's business operations.

CONCLUSION

Appellant respectfully submits that the questions presented in its Jurisdictional Statement involve substantial federal issues. The Appellee's position represents an extension of the unitary business principle not previously sanctioned by this Court. The application of this principle is based upon factors this Court has found insufficient to evidence a unitary business. Finally, the income attributed to Montana by use of its three-factor formula is not rationally related to the intrastate values of the Appellant's business. These issues warrant plenary consideration by this Court following submission of briefs and oral argument. Accordingly, Appellant respectfully requests that probable jurisdiction be noted.

Respectfully Submitted.

Ward A. Shanahan
301 First National Bank Bldg.
P.O. Box 1715
Helena, MT 59624

Counsel for Appellant

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